Supreme Court, U.S.
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No. -

In The
Supreme Court of the United States

GERALD K. SMITH, as the Litigation Trustee of the Farmland Dairies LLC Litigation Trust; G. PETER PAPPAS, as the Plan Administrator of the Plan of Liquidation of Parmalat-USA Corporation,
Petitioners,

v.

Bank of America Corporation, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Second Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Whether a plaintiff alleging fraud must plead with particularity facts giving rise to a strong inference of the requisite state of mind of the defendant, where the plaintiff's claim is not subject to the pleading requirements of the Private Securities Litigation Reform Act of 1995 ("PSLRA"), codified at 15 U.S.C. § 78u-4(b). There is a split among the circuit courts of appeals on this issue.

Whether a district court, in deciding a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure, may properly consider documents for the truth of the matters asserted therein, without converting the motion to one for summary judgment pursuant to Rule 12(d), where such documents are not "written instruments" within the meaning of Rule 10(c), are outside the pleadings, and are not the basis of the plaintiff's claims but rather are merely quoted or referenced in the plaintiff's complaint. There is no unanimity among the federal courts as to when and for what purposes such documents may be considered on a motion to dismiss.

RULE 14.1(b) STATEMENT

A list of all parties to the proceeding in the court whose judgment is the subject of this petition is as follows:

Plaintiffs / Appellants: Gerald K. Smith, as the Litigation Trustee of the Farmland Dairies LLC Litigation Trust ("Farmland"); G. Peter Pappas, as the Plan Administrator of the Plan of Liquidation of Parmalat-USA Corporation ("Parmalat-USA") (collectively, "Plaintiffs" or "Petitioners").

Defendants / Appellees: Bank of America Corporation; Bank of America, N.A.; Bank of America National Trust & Savings Association; Banc of America Securities LLC; Banc of America Securities Limited; BankAmerica International Limited (collectively, "BoA"); Grant Thornton International ("GTI"); Grant Thornton, LLP ("GT-USA"); Grant Thornton, S.p.A., now known as Italaudit, S.p.A. ("GT-Italy"); Deloitte & Touche USA, LLP; Deloitte & Touche, LLP (collectively, "Deloitte-USA"); Deloitte & Touche, S.p.A. ("Deloitte-Italy"); Deloitte Touche Tohmatsu ("DTT"); Credit Suisse First Boston; Credit Suisse, Credit Suisse International, Credit Suisse Securities Europe Limited (collectively, "CSFB"); Banca Nazionale del Lavoro, S.p.A. ("BNL"); Banca Intesa, S.p.A. ("Intesa").

RULE 29(6) STATEMENT

Petitioner Gerald K. Smith, as the Litigation Trustee of the Farmland Dairies LLC Litigation Trust, states that the Trust does not issue stock and therefore does not have a parent corporation or stockholder owning 10% or more of its stock.

G. Peter Pappas, as the Plan Administrator of the Plan of Liquidation of Parmalat-USA Corporation, states that the Corporation was, prior to its bankruptcy, wholly owned by Parmalat S.p.A., an Italian company. Under the Corporation's plan of liquidation, stockholders' rights have been extinguished, and the Corporation therefore does not have a parent corporation or stockholder owning 10% or more of its stock.

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PETITION FOR WRIT OF CERTIORARI

Petitioners respectfully request a writ of certiorari on the decision below of the United States Court of Appeals, Second Circuit.

OPINIONS BELOW

The Second Circuit's decision, summarily affirming the United States District Court, Southern District of New York, is attached as Appendix A. The district court's opinion dismissing Plaintiffs' claims is attached as Appendix E and published as *In re Parmalat Securities Litigation*, 501 F. Supp. 2d 560 (S.D.N.Y. 2007).

JURISDICTION

The Second Circuit's decision was entered February 17, 2009. App. 1a. This petition is timely under 28 U.S.C. § 2101 and Supreme Court Rules 13(1) and 13(3) because it is filed within 90 days of the Second Circuit's order. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

15 U.S.C. § 78u-4(b), requiring heightened particularity in pleading certain claims under federal securities laws, is attached as Appendix F.

STATEMENT OF THE CASE

Parmalat was an Italian conglomerate consisting of Parmalat-SpA and related companies. Prior to bankruptcy, Parmalat-USA was a subsidiary of

Parmalat-SpA. In 1999, Parmalat-USA acquired Farmland, which became Parmalat-USA's primary operating subsidiary.[1]

By 1996, corrupt officers and directors ("Culpable Insiders") of Parmalat, with Defendants' assistance, conspired to conceal growing financial problems. The conspirators hid operating losses for nearly a decade, understated debt by nearly $10 billion, and overstated net assets by $16.4 billion through the use of fraudulent transactions, bogus bank accounts, and forged financial records. Bank Defendants – BoA, CSFB, BNL, and Intesa – participated in transactions with Parmalat generating fictitious assets or mischaracterizing debt as equity. Deloitte-Italy and GT-Italy[2] certified Parmalat's financial statements. These deceptions assisted the Culpable Insiders in looting Parmalat and its subsidiaries.

As part of this scheme, the Culpable Insiders deceived Farmland's innocent decision-makers into approving a transaction called the "Master Lease." On April 30, 2003, Farmland conveyed its plants and equipment to General Electric Capital Corporation ("GECC") for $100 million, then leased back these assets. The proceeds were diverted to Parmalat-Canada and Parmalat-SpA, as contemplated from the outset, to fund the fraud. Farmland was stripped of its

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[1] Facts are taken from Plaintiffs' complaints. Because this case was dismissed on the pleadings, the allegations must be taken as true. *E.g.*, *SEC v. Edwards*, 540 U.S. 389, 391 (2004).

[2] GT-Italy is defunct, but Plaintiffs sue to hold GTI and GT-USA vicariously liable.

operating assets and saddled with debt it could not repay.

The terms of the transaction required that Farmland's operating assets be valued at least 1.3 times the transaction amount. Although Deloitte-USA was serving as Farmland and Parmalat-USA's independent auditor, Deloitte-USA agreed to perform the appraisal, violating its duty to maintain independence. Deloitte-Italy's engagement partner strenuously objected to the engagement due to the obvious conflict of interest. Deloitte-USA manipulated its appraisal to reach the value needed to allow the transaction to proceed, overvaluing Farmland's assets far beyond what could be justified by its historic performance and far higher than any value assigned by any previous appraisal.

In connection with the Master Lease, Deloitte-USA provided to GECC Parmalat-USA's 2000 and 2001 audited, and 2002 unaudited, financial statements. Deloitte-Italy provided Parmalat-SpA's 2001 and 2002 audited financial statements and answered questions from GECC with respect thereto. Deloitte-USA and Deloitte-Italy thus knew these financial statements would be relied upon.

A critical element of the Parmalat fraud was the issuance of so-called "reimbursement credits" to subsidiaries worldwide, primarily through an affiliated Cayman Islands entity, Bonlat. In order to increase reported income and conceal violations of Parmalat-SpA's financial covenants, it was essential that the credits be reflected on the income statement – not just on the balance sheet. To accomplish this, the Culpable Insiders characterized the credits as reimbursements

for expenses incurred by subsidiaries that purportedly benefited the whole Parmalat group. From 1995 through 2003, at least $155 million of "reimbursement credits" were recorded on Parmalat-USA's books.

The "reimbursement credits" had no legitimate purpose; the Culpable Insiders referred to them internally as "loss absorptions." None of the credits was actually collected. Moreover, the credits were invariably booked after the close of each reporting period and after the extent of Parmalat-USA's losses had been determined.

Because the "reimbursement credits" were material, related-party transactions, generally accepted auditing standards ("GAAS") required Deloitte-USA to audit the credits with heightened skepticism and insist on evidence to support their collectibility and their recording as a reduction of legitimately incurred expenses that benefited the Parmalat group. For each year 2000 through 2002, Deloitte-USA sought from Parmalat-SpA and Deloitte-Italy audit evidence regarding the calculation, purpose, collectibility, and accounting treatment of the credits.

Deloitte-Italy and Parmalat-SpA, however, repeatedly refused to provide evidence. Deloitte-USA never saw any agreement, contract, invoice, promissory note, or other evidence substantiating any expense incurred on behalf of Parmalat or any obligation, let alone capability, of Bonlat or any other issuer to pay the credits. This should have prompted Deloitte-USA to refuse to issue a clean opinion.

GAAS also required that Deloitte-USA evaluate the ability of Parmalat-USA to continue operating as a

going concern. Due to Parmalat-USA's debt guaranteed by Parmalat-SpA, the survival of Parmalat-USA depended on financial support and loan guarantees from Parmalat-SpA. GAAS required that Deloitte-USA obtain evidence demonstrating the ability of Parmalat-SpA to provide financial support, serve as an acceptable guarantor for Parmalat-USA's third-party borrowings, and forebear from calling Parmalat-USA's intercompany debt. Despite recognizing the need for such evidence, Deloitte-USA each year accepted bare representations from Parmalat-SpA's management that Parmalat-SpA intended to provide support.

When the truth about Bonlat was exposed, Parmalat-SpA was forced into the Italian equivalent of bankruptcy. Farmland was unable to make its lease payments, and Parmalat-SpA was unable to honor its guarantee. Stripped of physical assets and cash, Farmland filed bankruptcy on February 24, 2004. On January 18, 2006, Plaintiffs commenced this action, bringing claims for negligence/malpractice, fraud, fraudulent conveyance, breach of fiduciary duty, and claims under federal and New Jersey RICO. Plaintiffs did not bring securities claims, but their cases were coordinated for pretrial purposes with the MDL proceedings styled *In re Parmalat Securities Litigation*, 04 MD 1653.

On August 8, 2007, the district court dismissed Plaintiffs' claims for failure to plead proximate causation. App. 16a. The court recognized that Deloitte-USA, as auditor of Plaintiffs' financial statements and appraiser for the Master Lease, stood in a "unique position" with respect to Plaintiffs but nonetheless dismissed the claims against Deloitte-

USA, concluding Plaintiffs failed to plead facts giving rise to a "strong inference" that Deloitte-USA had knowledge of the fraud such that loss of Farmland's assets was a foreseeable result of the Master Lease.

Plaintiffs appealed to the Second Circuit, which summarily affirmed. App. 1a.

REASONS FOR GRANTING THE WRIT

In considering Plaintiffs' motions to dismiss, the district court applied a pleading standard equivalent to that of the PSLRA, holding Plaintiffs must "allege facts that give rise to a 'strong inference' of the defendant's culpable state of mind." App. 40a. However, it is undisputed that Plaintiffs' claims are not governed by the PSLRA. *See* 15 U.S.C. § 78u-4(b)(2) (pleading standard applies to "any private action arising under this [Securities Exchange] Act [of 1934]"). Rather, Plaintiffs' claims are governed by Rule 8(a), Fed. R. Civ. P., which requires only "a short and plain statement of the claim," and, to the extent their claims sound in fraud, Rule 9(b), which provides that "[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally."

The Second Circuit is the only federal court applying this heightened pleading standard outside the PSLRA. Other federal courts either permit a "general[]" allegation of the requisite state of mind under Rule 9(b) or require only *some* factual basis for an inference of state of mind. This Court should grant certiorari to resolve this circuit split and to enforce the judgment of Congress that the PSLRA's pleading standard should apply only to cases governed by it.

Also, the district court considered two appraisal reports and a section of the audit guide promulgated by the American Institute of Certified Public Accountants ("AICPA"). These documents were not attached to or incorporated by reference into Plaintiffs' complaints, nor do they form the legal basis of Plaintiffs' claims. The district court assumed the truth of assertions in these documents and used them to rebut Plaintiffs' allegations.

There is conflict among federal courts with respect to the consideration of extraneous documents on a motion to dismiss. The courts disagree on whether such documents are limited to "written instruments" under Rule 10(c), Fed. R. Civ. P., or whether evidentiary documents may be relied upon as the district court did below. The courts also disagree on the extent to which a complaint may make reference to a document before it becomes part of the pleadings considered on a motion to dismiss. For example, some courts hold a document may be considered only if it is central to the claim – that is, it defines the rights and obligations sued upon – while other courts, such as the district court below, allow consideration of any document quoted or referenced in the complaint. Finally, the courts disagree on whether a document may be relied upon for the truth of statements therein, as the district court did below, or whether it may be used only for limited purposes, such as to determine its legal effect or to determine that statements were made. This Court should grant certiorari to resolve these conflicts and to enforce compliance with the plain dictate of the Rules.

I. THIS COURT SHOULD GRANT CERTIORARI ON THE QUESTION WHETHER THE COURT BELOW PROPERLY CONSTRUED RULE 9(B) IN A NON-SECURITIES CASE.

A. This Question Affects the Rights of Innumerable Civil Litigants.

Commentators have noted an "increase in motion practices under Rule 9(b)." 5A Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 1297, at 169 (3d ed. 2004). "Rule 9(b) motions, often in conjunction with Rule 12(b)(6) motions, appear to be made routinely, and courts are now demanding more specificity and granting the motions with greater frequency than in the past or in other legal contexts." Arthur R. Miller, *The Pretrial Rush to Judgment: Are the "Litigation Explosion," "Liability Crisis," and Efficiency Clichés Eroding Our Day in Court and Jury Trial Commitments?*, 78 N.Y.U. L. Rev. 982, 1011 (June 2003).

These practices have effects, direct and indirect, on citizens' procedural rights: "The explicit use of procedural modifications to promote efficiency values undoubtedly influences the way judges use their discretionary powers, reorients civil litigation objectives, and inevitably affects other systemic values." *Id.* at 1003. Procedural requirements, especially pleading standards at issue here, also have consequences on substantive rights: "In the guise of tinkering with procedural requirements, Congress has effectively, for policy reasons, *made it substantively harder* for plaintiffs to bring securities fraud cases, through the 'strong inference' of scienter requirement." *Greebel v. FTP Software, Inc.*, 194 F.3d 185, 196 n.9

(1st Cir. 1999) (emphasis added); *see also* Miller, *supra*, at 1071 ("Under the guise of characterizing the plaintiff's case as 'implausible,' ... a trial court actually may redefine the scope of the substantive law by destroying the viability of certain theories of recovery it believes should be 'disfavored' or by simply preventing state-of-mind questions from reaching juries on the unstated premise that the judge is avoiding speculation.").

As judicial scrutiny of pleadings intensifies, it becomes more difficult and expensive for plaintiffs to bring meritorious claims, and courts become closed to entire classes of citizens. Here, an impossible pleading hurdle was set in the path of Plaintiffs, bankruptcy court-appointed trustees who must "plead fraud on secondhand knowledge for the benefit of the estate and all of its creditors." *Hassett v. Zimmerman (In re O.P.M. Leasing Servs., Inc.)*, 32 B.R. 199, 203 (Bankr. S.D.N.Y. 1983). Further, it becomes more difficult for plaintiffs to develop and refine their case through discovery, as contemplated by the Federal Rules of Civil Procedure.

Ultra-heightened pleading standards, having severe effects on substantive rights, should not be imposed by courts where Congress left the vast majority of fraud claims outside the scope of the super-particularity standard of the PSLRA. Courts especially should not make such a change without going through proper channels for amending the Rules. In *Swierkiewicz v. Sorema N.A.*, 534 U.S. 506, 513-14 (2002), this Court unanimously affirmed that the Rules apply "to all civil actions," reinforcing the principle that their pleading standards operate "without regard to whether a claim will succeed on the

merits," *id.* at 515, and pointing up the error in how Rule 9(b) was employed below, absent any direction by Congress to do so and contrary to the Rule's plain language.

B. Federal Courts Disagree on the Proper Standard.

"One of the shaping purposes of the Federal Rules is to bring about uniformity in the federal courts by getting away from local rules." *Hanna v. Plumer*, 380 U.S. 460, 472 (1965) (quotation marks omitted). However, there is variance among the federal courts in their interpretations of Rule 9(b), particularly as pertaining to pleading state of mind, leading to disparate outcomes among different circuits. This Court should grant certiorari to resolve this disagreement.

This Court recently identified – but left unresolved – this conflict as it existed prior to the PSLRA's enactment. *See Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2507-08 (2007). Congress resolved this conflict – with respect to certain claims under federal securities laws – by mandating, among other things, that complaints alleging securities fraud "'state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.'" *Id.* at 2508 (quoting 15 U.S.C. § 78u-4(b)(2)). However, Congress did not resolve this conflict with respect to the application of Rule 9(b) to claims *outside* federal securities laws. Nor did Congress, by enacting the PSLRA, endorse the Second Circuit's interpretation of Rule 9(b). Rather, if Congress had wished to endorse such an interpretation, it would have drafted the statute to

apply to *all* cases governed by 9(b). By imposing the ultra-heightened pleading requirement only on a subset of disfavored claims, Congress implicitly repudiated the Second Circuit's interpretation. Nevertheless, divergence remains among the circuits with respect to Rule 9(b) interpretation outside the PSLRA.

1. The district court followed the Second Circuit standard requiring that Plaintiff plead with particularity facts giving rise to a strong inference of the requisite state of mind in non-securities cases.

In ruling on the motions to dismiss below, the district court followed the ultra-heightened pleading standard of the PSLRA: "While [Rule 9(b)] allows general averments of intent, knowledge, and other mental conditions, it nevertheless requires a plaintiff to allege facts that give rise to a 'strong inference' of the defendant's culpable state of mind." App. 40a (citing, *inter alia*, *Tellabs*, 127 S. Ct. at 2510); *see also id.* at 60a.[3] Second Circuit courts have long applied this standard, even prior to the PSLRA. *See, e.g.*, *Cosmas v. Hassett*, 886 F.2d 8, 12-13 (2d Cir. 1989).

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[3] In articulating this standard, the district court did not repeat the PSLRA language requiring such facts to be pled "with particularity." *Cf.* 15 U.S.C. § 78u-4(b)(2). However, in applying the standard, Judge Kaplan refused to credit any allegations not pled with particularity. *See, e.g.*, App. 65a ("A bald allegation that Deloitte USA said one thing and did another is too conclusory to satisfy Rule 9(b)."). Moreover, the district court relied on case law from post-PSLRA private securities actions. *See id.* at 65a nn.131-32, 66a n.133, 67a nn.134-37, 68a n.138, 70a n.141.

2. Other federal courts require only a general allegation of state of mind under a literal interpretation of Rule 9(b).

(a) Ninth Circuit.

The Ninth Circuit has noted that the Second Circuit's "strong inference" test "conflicts with authority from this circuit, most notably *Walling v. Beverly Enters.*, in which we stated that Rule 9(b) does not require '*any* particularity in connection with an averment of intent, knowledge or condition of the mind.'" *In re GlenFed, Inc. Secs. Litig.*, 42 F.3d 1541, 1545 (9th Cir. 1994) (*en banc*) (quoting *Walling v. Beverly Enters.*, 476 F.2d 393, 397 (9th Cir. 1973)).[4]

(b) Tenth Circuit.

The Tenth Circuit follows the same literal interpretation of Rule 9(b) as the Ninth Circuit: "True to the rule's straightforward language, this court has held that Rule 9(b) requires only the identification of

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[4] Several decisions discussed here were decided pre-PSLRA. Such decisions have been superseded by the PSLRA with respect to securities fraud claims. *See, e.g.*, *Ronconi v. Larkin*, 253 F.3d 423, 429 (9th Cir. 2001). However, these cases continue to apply to claims, such as here, that are not governed by the PSLRA. *See, e.g.*, *Odom v. Microsoft Corp.*, 486 F.3d 541, 554 (9th Cir. 2007) (relying on *GlenFed* in case not governed by PSLRA); *Vess v. Ciba-Geigy Corp.*, 317 F.3d 1097, 1106 (9th Cir. 2003) (same); *Flowers v. Carville*, 310 F.3d 1118, 1130 (9th Cir. 2002) (same); *cf. Ronconi*, 253 F.3d at 437 ("The heightened pleading requirements of the Private Securities Litigation Reform Act are an unusual deviation from the usually lenient requirements of federal rules pleading.").

the circumstances constituting fraud, and that it does not require any particularity in connection with an averment of intent, knowledge or condition of mind." *Schwartz v. Celestial Seasonings, Inc.*, 124 F.3d 1246, 1252 (10th Cir. 1997); *see also, e.g., Scheidt v. Klein*, 956 F.2d 963, 967 (10th Cir. 1992); *Seattle-First Nat. Bank v. Carlstedt*, 800 F.2d 1008, 1011 (10th Cir. 1986).

The Tenth Circuit has acknowledged its interpretation conflicts with law from other circuits: "[S]ome cases have held that a plaintiff making a general averment as to a defendant's intent must also allege facts that create a 'strong inference' that the defendant possessed the averred intent. Absent Rule 9(b), the approach taken in those cases requiring more specific factual allegations would have considerable appeal. However, because we cannot reconcile that approach with the plain language of Rule 9(b), we do not adopt it." *Phelps v. Wichita Eagle-Beacon*, 886 F.2d 1262, 1270 n.5 (10th Cir. 1989) (citations omitted).

(c) Sixth Circuit.

The Sixth Circuit has likewise followed Rule 9(b) strictly. *See, e.g., United States ex rel. SNAPP, Inc. v. Ford Motor Co.*, 532 F.3d 496, 505 (6th Cir. 2008) (knowledge "does not need to be pled with particularity;" "inquiry regarding [defendant's] state of mind may only be pled generally"); *United States ex rel. Bledsoe v. Cmty. Health Sys., Inc.*, 501 F.3d 493, 504 (6th Cir. 2007) ("Rule 9(b) requires that for all 'averments of fraud,' 'the circumstances constituting fraud' must be pled with 'particularity,' in contrast to the *mens rea* of fraud, which may be pled 'generally.'");

United States ex rel. Bledsoe v. Cmty. Health Sys., Inc., 342 F.3d 634, 642 (6th Cir. 2003) ("Relator is not required to state with particularity Defendant's intent to defraud ...."); *Vector Research, Inc. v. Howard & Howard Attorneys P.C.*, 76 F.3d 692, 700 (6th Cir. 1996).

(d) Seventh Circuit.

Most Seventh Circuit courts adhere to the language of Rule 9(b) and require only a general allegation of state of mind. For example, *Hefferman v. Bass*, 467 F.3d 596, 602 (7th Cir. 2006), held sufficient a complaint alleging generally that defendant's participation in "fraud and breach of fiduciary duty was knowing and intentional." *See also, e.g., Triad Assocs., Inc. v. Robinson*, 10 F.3d 492, 497 (7th Cir. 1993) ("[W]e require no more from plaintiffs' allegations of intent than what would satisfy Rule 8's notice pleading minimum and Rule 9(b)'s requirement that motive and intent be pleaded generally."); *LFG, LLC v. Navarre*, No. 01C9451, 2002 WL 1379112, at *2 (N.D. Ill. June 26, 2002) ("[B]ecause Rule 9(b) requires only that intent be pleaded generally, LFG does not have to allege how or why the Navarres knew the act was *ultra vires*."); *Kohler Co. v. Kohler Intern., Ltd.*, 196 F. Supp. 2d 690, 695 (N.D. Ill. 2002) ("Wilfulness is a state of mind and may be averred generally."); *Petri v. Gatlin*, 997 F. Supp. 956, 976 (N.D. Ill. 1997) ("[T]he text of Rule 9(b) counsels against dismissal for failure to plead fraudulent intent with specificity. The rule is explicit: 'Malice, intent, knowledge, and other condition of mind of a person may be averred generally.'"); *Whirlpool Fin. Corp. v. GN Holdings, Inc.*, 873 F. Supp. 111, 118 n.11 (N.D. Ill. 1995) ("Rule 9(b) does not require particularized pleading of states

of mind or of facts that if true would show that the defendant's alleged misrepresentations were indeed false."), *aff'd*, 873 F.3d 605; *cf. Bankers Trust Co. v. Old Republic Ins. Co.*, 959 F.2d 677, 683 (7th Cir. 1992) ("The reported cases ... do not require [plaintiff] to plead facts showing that the representation is indeed false.").

However, there appears to be some disagreement within the circuit: One widely cited case states, "Although Rule 9(b) does not require 'particularity' with respect to the defendants' mental state, the complaint still must afford a basis for believing that plaintiffs could prove scienter." *DiLeo v. Ernst & Young*, 901 F.2d 624, 629 (7th Cir. 1990).

(e) Third Circuit.

No federal circuit has embraced the Second Circuit's pleading standards outside the context of the PSLRA. The court coming closest was the Third Circuit. In one securities fraud case that arose pre-PSLRA but was decided after the enactment of the statute, the court stated that it "agree[d] with the Second Circuit's approach." *In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1418 (3d Cir. 1997). However, this holding has not been extended outside the context of securities fraud. *See United States ex rel. Atkinson v. Pa. Shipbuilding Co.*, 255 F. Supp. 2d 351, 412 (E.D. Pa. 2002) (declining to apply *Burlington* outside PSLRA). In upholding an intentional discrimination claim, a Third Circuit panel emphasized that "'[m]alice, *intent*, knowledge, and other *condition of mind* of a person may be averred *generally*.'" *Pryor v. Nat'l Collegiate Athletic Ass'n.*, 288 F.3d 548, 564 (3d Cir. 2002) (quoting Fed. R. Civ.

P. 9(b)); *see also, e.g.*, *Kalow & Springnut, LLP v. Commence Corp.*, No. 07-3442(FLW), 2008 WL 2557506, at *4 (D.N.J. June 23, 2008) ("Rule 9(b) allows ... intent[] to be alleged generally."); *Lerch v. Citizens First Bancorp, Inc.*, 805 F. Supp. 1142, 1152 (D.N.J. 1992) ("This standard is satisfied where plaintiff alleges generally that defendants had actual knowledge of the materially false and misleading statements and omissions or acted with reckless disregard for the truth." (quotation marks and alterations omitted)).

3. Other federal courts require only some factual basis for an allegation of state of mind.

Several courts have taken intermediate approaches, holding a general allegation of state of mind is not sufficient itself and must be supported by some additional allegations. But these courts do not go so far as the Second Circuit's requirement that the plaintiff plead with particularity facts supporting a "strong inference" of state of mind where the PSLRA does not apply.

(a) First Circuit.

The First Circuit appears to follow a rule requiring only an allegation of *some* facts supporting an inference of intent: "Although a plaintiff need not specify the circumstances or evidence from which fraudulent intent could be inferred, the complaint must provide some factual support for the allegations of fraud ...." *Romani v. Shearson Lehman Hutton*, 929 F.2d 875, 878 (1st Cir. 1991); *see also, e.g.*, *Lucia v. Prospect Street High Income Portfolio, Inc.*, 36 F.3d

170, 174 (1st Cir. 1994) ("General averments of the defendants' knowledge of material falsity will not suffice. Consistent with Fed.R.Civ.P. 9(b), the complaint must set forth specific facts that make it reasonable to believe that defendants knew that a statement was materially false or misleading." (alternations and citation omitted)).

However, the First Circuit's pronouncements have been haphazard. *Compare Greebel*, 194 F.3d at 197 (noting First Circuit's "pre-[PSLRA] case law had used both the language of 'strong' inference and of 'reasonable' inference in various contexts"), *with Educadores Puertorriquenos en Accion v. Hernandez*, 367 F.3d 61, 66 (1st Cir. 2004) ("State of mind, including motive and intent, may be averred generally."); *Doyle v. Hasbro, Inc.*, 103 F.3d 186, 194 (1st Cir. 1996) ("'Rule 9 requires specification of the time, place, and content of an alleged false representation, but not the circumstances or evidence from which fraudulent intent could be inferred.'" (quoting *McGinty' v. Beranger Volkswagen, Inc.*, 633 F.2d 226, 228 (1st Cir. 1980))).

(b) Fifth Circuit.

The Fifth Circuit also exhibits internal tension. One panel held, "To plead scienter adequately, a plaintiff must set forth specific facts that support an inference of fraud." *Tuchman v. DSC Communications Corp.*, 14 F.3d 1061, 1068 (5th Cir. 1994). Another panel held a general allegation of "actual malice" was "sufficient on its face" for purposes of a libel complaint, stating that "the Federal Rules of Civil Procedure require only that 'Malice, intent, knowledge, and other condition of mind of a person ... be averred generally.'"

Belli v. Orlando Daily Newspapers, Inc., 389 F.2d 579, 589 (5th Cir. 1967); *see also United States ex rel. Wilkins v. N. Am. Const. Corp.*, 173 F. Supp. 2d 601, 614 (S.D. Tex. 2001) ("The second sentence of Rule 9(b) allows a plaintiff to make conclusory allegations as to defendant's knowledge of the true facts and of defendant's intent to deceive.").

(c) Fourth Circuit.

The Fourth Circuit recently stated that "[a]lthough '[m]alice, intent, knowledge, and other conditions of a person's mind may be alleged generally,' ... plaintiff still 'must set forth specific facts that support an inference of fraud.'" *United States ex rel. Wilson v. Kellogg Brown & Root, Inc.*, 525 F.3d 370, 379 (4th Cir. 2008) (quoting *United States ex rel. Willard v. Humana Health Plan Inc.*, 336 F.3d 375, 385 (5th Cir. 2003)).

(d) Sixth Circuit.

The Sixth Circuit holds that "allegations of fraudulent misrepresentation must be made with sufficient particularity and with a sufficient factual basis to support an inference that they were knowingly made." *Coffey v. Foamex L.P.*, 2 F.3d 157, 162 (6th Cir. 1993) (quotation marks omitted).

C. The Standard Applied Below Conflicts with the Plain Language of the Federal Rules of Civil Procedure and PSLRA.

1. Federal courts are required to adhere to the Rules of Civil Procedure.

Adherence to the Rules of Civil Procedure is not optional: "When a situation is covered by one of the Federal Rules, ... the court has been instructed to apply the Federal Rule ...." *Hanna v. Plumer*, 380 U.S. 460, 471 (1965). This Court's "cases demonstrate that questions regarding pleading ... are most frequently and most effectively resolved either by the rulemaking process or the legislative process." *Crawford-El v. Britton*, 523 U.S. 574, 594-95 (1998). Thus, it is not appropriate for a court, as the Second Circuit has done, to impose a pleading requirement beyond what is mandated by the Rules, merely because it does not like a certain species of litigation. *Cf. Leatherman v. Tarrant County Narcotics Intelligence & Coordination Unit*, 507 U.S. 163, 168-69 (1993) (courts may not set heightened pleading standard: "that is a result which must be obtained by the process of amending the Federal Rules, and not by judicial interpretation. In the absence of such an amendment, federal courts and litigants must rely on summary judgment and control of discovery to weed out unmeritorious claims ....").

2. Rule 9(b) requires only the "circumstances" of the fraud be pled with particularity; state of mind may be averred "generally."

Federal courts are largely in agreement that the "circumstances constituting fraud" that must be pled with particularity under Rule 9(b) are "the who, what, when, where, and how: the first paragraph of any newspaper story." *DiLeo*, 901 F.2d at 627. Where the Second Circuit standard departs from the plain language of the Rule is in its requirement for allegations of state of mind. The Ninth Circuit, sitting *en banc*, explained:

> The second sentence of Rule 9(b) is very clear: "Malice, intent, knowledge, and other condition of mind may be averred generally." The model for Rule 9(b), Order 19, Rule 22 of the English Rules of Practice of 1937, is clearer still: "Wherever it is material to allege malice, fraudulent intention, knowledge, or other condition of the mind of any person, it shall be sufficient to allege the same as a fact *without setting out the circumstances from which the same is to be inferred*." The Second Circuit's test is precisely the opposite of the English rule, and is irreconcilable with the second sentence of Rule 9(b).

GlenFed, 42 F.3d at 1545 (citation omitted). A concurring judge opined that the Second Circuit standard "does unnecessary violence to the fundamental tenets of notice pleading" and has led to complaints that "now commonly read more like summary judgment papers than pleadings designed to

give defendants notice of the particular misconduct which is alleged to constitute the fraud charged." *Id.* at 1555 (Norris, J.) (quotation marks omitted).

The Ninth Circuit *en banc* further explained that departure from the plain language of the Rules is not justified by disfavor toward any category of lawsuits:

> The Second Circuit's test may or may not have the effect of deterring or weeding out "strike suits," which various courts have seen as imposing undesirable social and economic costs. Whether the test has such an effect is beside the point. We are not permitted to add new requirements to Rule 9(b) simply because we like the effects of doing so. This is a job for Congress, or for the various legislative, judicial, and advisory bodies involved in the process of amending the Federal Rules.

Id. at 1546 (citations omitted).

Some federal courts have adopted a milder formulation of the Second Circuit standard. Under this formulation, a plaintiff need not allege facts supporting a *strong* inference of intent, only facts supporting *some* inference of intent. *See supra* Part I.B.3. This formulation is also contrary to the plain language of Rule 9(b):

> We find no more justification for a "some inference" test than we did for the Second Circuit's "strong inference" test. It conflicts both with the English rule which was the model for Rule 9(b) and with the second sentence of Rule 9(b) itself, which declares unequivocally that

> state of mind may be averred generally, and says absolutely nothing about required inferences.

GlenFed, 42 F.3d at 1546.

Commentators have criticized these judicially imposed pleading standards. Professor Miller opines that recent trends allowing elements of summary adjudication to be "brought back along the litigation time line from summary judgment to the motion to dismiss" are "completely inconsistent with the philosophy and principles of the Federal Rules in general and the pleading rules in particular" and, worse, threaten to encroach on plaintiffs' constitutionally guaranteed right to a trial by jury. Miller, *supra*, at 1072-74, 1093.

3. An ultra-heightened pleading standard is not justified by the PSLRA where it does not apply.

The PSLRA, far from justifying these pleading standards, forecloses their application in areas where the statute does not reach. Under the commonplace interpretive maxim *"[e]xpressio unius est exclusio alterius,"* *Leatherman*, 507 U.S. at 168, Congress's decision to impose a heightened pleading standard in a specific context implies a policy judgment that such standard should *not* apply in other contexts. As one court explained in declining to apply the PSLRA outside its boundaries, the statute "is limited ... to the securities laws. Unless one law expressly repeals or supersedes another, or the two create inconsistent demands, both must be enforced." *Rogers v. Baxter Intern., Inc.*, 521 F.3d 702, 705 (7th Cir. 2008). The

leading treatise has expressed disapproval of the creep of PSLRA standards from securities laws to other areas of law:

> Despite a handful of district court opinions extending Tellabs beyond the context of the PSLRA, such extensions are almost universally unwarranted.... [The PSLRA] created a narrow exception to the general notice pleading standard of the Federal Rules and courts should hesitate to apply Tellabs' stringent pleading standards to situations in which Congress has not clearly articulated the desire for similarly strict pleading requirements. The PSLRA's pleading requirements are the exception to the rule.

5A Wright & Miller, *supra*, § 1301.1, at 65-66 (Apr. 2009 Supp.).

D. Application of the Incorrect Standard Led the District Court to Err in Dismissing Plaintiffs' Claims.

Professor Miller has observed that an overly aggressive application of procedural rules may embolden a district court to "encroach[] on the factfinder's role" by "weigh[ing] evidence, draw[ing] inferences in favor of the moving party ..., ... mak[ing] credibility determinations," and "reject[ing] the plaintiffs' attempts to create inferences of intent and motive through a totality of circumstantial evidence, thereby creating a triable issue, by treating the evidence in a piecemeal fashion, isolating and rejecting as insufficient each of the discrete elements of the plaintiffs' evidence rather than considering their

cumulative effect." Miller, *supra*, at 1064-65.[5] This describes precisely what the district court did below. In ruling on Plaintiffs' complaints, the district court:

- discounted or ignored Plaintiffs' factual allegations, *see, e.g.*, App. 56a-57a (ignoring allegations that Deloitte-Italy participated in the Master Lease); *id.* at 68a-75a (discounting allegations concerning what GAAS required of Deloitte-USA));

- adopted excuses for Deloitte-USA's conduct based on self-serving statements from its appraisal report, which was outside the complaints and alleged to be fraudulent, *see id.* at 60a-65a;

- dismissed each allegation as insufficient "alone," "by itself," or "by themselves" to support Plaintiffs' claims, without considering the complaints as a whole, *see e.g.*, *id.* at 65a-66a & nn.131, 133; *id.* at 67a; *id.* at 77a; *id.* at 79a);

- drew inferences favorable to Defendants and conjured up "innocent explanation[s]" for Defendants' behavior unsupported by the complaints, while giving little or no weight to inferences to be drawn from the nature, number, and magnitude of Defendants' breaches of duty, *see, e.g.*, *id.* at 70a n.141

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[5] *See also id.* at 1073 n.482 ("The onerousness of the pleading requirements of the PSLRA, particularly as construed by some courts, has made the Rule 12(b)(6) motion terminal in some cases and obscured the reality that issues of fact arguably are being decided in the guise of enforcing the pleading standard.").

("While use of the phrases 'loss absorption' and 'to cover losses' perhaps was suspicious, Zucchinali's email reasonably can be read as an innocent explanation that the reimbursement credits were promises to pay Parmalat subsidiaries for losses sustained or expenses borne on behalf of the parent company."); and

- improperly determined questions of fact, *see, e.g.*, *id.* at 56a-58a (determining Farmland's injury was not "foreseeable" to the "defendants other than Deloitte USA"); *id.* at 71a-72a (determining what GAAS requires).

In sum, the district court intruded into "a subject rife with factual elements" by assuming the implausibility of Defendants' participation in and knowledge of the fraud. Miller, *supra*, at 1117-21.

II. THIS COURT SHOULD GRANT CERTIORARI ON THE QUESTION WHETHER THE COURT BELOW PROPERLY CONSIDERED DOCUMENTS OUTSIDE THE COMPLAINT.

In deciding the motions to dismiss, the district court considered – for the truth of statements therein – two appraisal reports and an AICPA audit guide. Though not attached as exhibits, the district court reasoned it could consider these documents because Plaintiffs purportedly "relied on" them in framing their complaints. App. 61a n.123, 71a n.142.

A. The Standard Applied Below Affects the Rights of Innumerable Civil Litigants in Federal Courts.

The standards applied by the district court affect virtually every civil plaintiff whose claims are subject to a motion to dismiss under Rule 12(b)(6), which has by now become *de rigueur* in federal civil practice. As motions to dismiss have become more common, so has reliance on extraneous documents become more common at the pleadings stage, as demonstrated by the cases cited below, which represent just an infinitesimal fraction of cases in which these issues arise. Lower courts, through the practice of considering documents on motions to dismiss, are *sub silentio* turning these motions into summary judgment proceedings. *In re Shopko Secs. Litig.*, No. 01-C-1034, 2002 WL 32003318, at *1 (E.D. Wis. Nov. 5, 2002) ("Considering such documents as part of the pleadings would . . eliminate the distinction between a motion for summary judgment and a motion to dismiss."). This Court should grant certiorari to ensure uniform practice, consistent with the Rules, with respect to the use of documents on motions to dismiss.

B. Federal Courts Disagree on When and for What Purposes Documents Outside the Complaint May Be Considered on a Motion to Dismiss.

There is inconsistency in the pronouncements and practices of lower courts in their consideration of extraneous documents. In most cases, as in the district court below, courts consider documents with little or no analysis as to whether and for what purposes they may consider them, stating only that

documents may be considered because the plaintiff referenced or relied on them in some undefined way and had possession or notice of them before filing a complaint. App. 61a n.123, 71a n.142; *see also, e.g.*, *In re Refco, Inc. Secs. Litig.*, 503 F. Supp. 2d 611, 623 (S.D.N.Y. 2007). The result has been unpredictability and a general trend in some courts toward motions to dismiss that bear uncanny resemblance to summary judgment motions.

1. Federal courts disagree on what types of documents may be considered.

Some courts adhere to Rule 10(c), Fed. R. Civ. P., which allows only a "written instrument" to be considered as "part of the pleading." *See infra* Part II.C.2. "The doctrine of incorporation by reference may apply, for example, when a plaintiff's claim about insurance coverage is based on the contents of a coverage plan, or when a plaintiff's claim about stock fraud is based on the contents of SEC filings." *United States v. Ritchie*, 342 F.3d 903, 908 (9th Cir. 2003) (citations omitted).

Other courts allow virtually any type of document to be incorporated under Rule 10(c). *See, e.g.*, *City of Rome v. Verizon Commc'ns, Inc.*, 362 F.3d 168, 175 (2d Cir. 2004) (letter may be "considered part of the complaint"); *Branch v. Tunnel*, 14 F.3d 449, 454 (9th Cir. 1994) (deposition transcript and affidavit may be considered because "expressly mentioned in the amended complaint"), *overruled on other grounds, Galbraith v. County of Santa Clara*, 307 F.3d 1119 (9th Cir. 2002); *N. Ind. Gun & Outdoor Shows, Inc. v. City of South Bend*, 163 F.3d 449, 453 (7th Cir. 1998) ("[T]his Court has interpreted the term 'written

instrument' as used in Rule 10(c) to include documents such as affidavits, and letters, as well as contracts, and loan documentation.").

A panel of the Seventh Circuit acknowledged its interpretation of Rule 10(c) is in conflict with at least the Third Circuit's interpretation. *N. Ind. Gun & Outdoor*, 163 F.3d at 453 n.4 (citing *Rose v. Bartle*, 871 F 2d 331, 339-40 n.3 (3d Cir.1989)); *see also infra* Part II.C.2. In fact, this panel's interpretation of Rule 10(c) is *also* in conflict with other panels *of the same court*. *See Levenstein v. Salafsky*, 164 F.3d 345, 347 (7th Cir.1998) ("While documents attached to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are *central* to his claim, this is a narrow exception aimed at cases interpreting, for example, a contract." (quotation marks and citation omitted)); *Perkins v. Silverstein*, 939 F.2d 463, 467 (7th Cir. 1991) ("The newspaper articles, commentaries and editorial cartoons which Perkins attached to the complaint referencing this 'scandal,' are not the type of documentary evidence or 'written instrument[s]' which Fed.R.Civ.P. 10(c) intended to be incorporated into, and made a part of, the complaint.").

2. Federal courts disagree on what reliance suffices to allow consideration of a document.

Some federal courts allow consideration of a document only if the plaintiff's claim is "based on" it – that is, the plaintiff's legal rights emanate from the document. *E.g.*, *Pension Benefit Guar. Corp. v. White Consolidated Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir. 1993) (allowing consideration of benefit plan on which

suit was based but refusing to consider letters between parties). Similar tests have been articulated permitting consideration of documents "central," "dispositive," or "integral" to the plaintiff's claims. *E.g.*, *id.*; *Chambers v. Time Warner*, Inc., 282 F.3d 147, 153 (2d Cir. 2002) (to be considered on motion to dismiss, complaint must "rel[y] heavily upon [the document's] terms and effect" such that the document is "integral to the complaint"); *Field v. Trump*, 850 F.2d 938, 949 (2d Cir. 1988).[6]

Other courts hold that *any* allegation of a document's contents is sufficient to allow consideration of that document. *See, e.g.*, *Branch*, 14 F.3d at 454. This is contrary to the test articulated above as well as authority which holds that "[l]imited quotation does not constitute incorporation by reference." *Cosmas*, 886 F.2d at 13 (quotation marks omitted); *see also, e.g.*, *Friedman v. Lansdale Parking Authority*, 151 F.R.D. 42, 44 (E.D. Pa. 1993) (documents not incorporated by reference where "plaintiffs summarize the representations made in the documents and only make use of one short quotation from any of the documents").

The Ninth Circuit takes yet another approach, holding that a document may be considered even if it

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[6] Most courts, including the Second Circuit, require that "it must be clear on the record that no dispute exists regarding the authenticity or accuracy of the document." *Faulkner v. Beer*, 463 F.3d 130, 134 (2d Cir. 2006). "It must also be clear that there exist no material disputed issues of fact regarding the relevance of the document." *Id.* Here, the district court failed to acknowledge that Plaintiffs dispute the accuracy and relevance of Deloitte-USA's appraisal report.

is not referenced in the complaint at all, so long as it is "necessarily relie[d]" upon in bringing the complaint. *Parrino v. FHP, Inc.*, 146 F.3d 699, 706 (9th Cir. 1998); *but see Cooper v. Pickett*, 137 F.3d 616, 623 (9th Cir. 1997) (declining to consider transcripts of conference calls where "[i]n the complaint, plaintiffs make allegations about the conference calls, but do not expressly mention or refer to the transcripts, or even identify their existence").

3. Federal courts disagree on the purposes for which a document may be considered.

Even if a document outside the complaint may be considered on a motion to dismiss, the question remains for what purposes the court may consider it. There are several possible purposes, including to determine whether statements were made, to determine the legal effect of statements, or to accept statements for their truth.

Some courts have permitted a document to be considered only for the purpose of determining whether statements were made. *See infra* Part II.C.3.

Other courts have permitted a document to be considered only for the purpose of determining the legal effect of the document. For example, in a suit to enforce rights under a contract or benefit plan, courts have considered the contract or benefit plan to make a legal determination as to the parties' respective rights and duties under such document. *See, e.g.*, *Ed Miniat Inc. v. Globe Life Ins. Group*, 805 F.2d 732, 738-39 & n.12 (7th Cir. 1986); *Bechtel Corp. v. Local 215, Laborers' Int'l Union*, 405 F. Supp. 370 (M.D. Pa.

1975), *aff'd*, 544 F.2d 1207. Similarly, published documents have been considered for the purpose of determining their legal import under the law of libel and false light. *See, e.g.*, *Fudge v. Penthouse Int'l, Ltd.*, 840 F.2d 1012, 1014-15 (1st Cir. 1988).

The Ninth Circuit takes a third approach, allowing consideration of a document for the purpose of accepting its truth: "The defendant may offer such a document, and the district court may treat such a document as part of the complaint, and thus may assume that its contents are true for purposes of a motion to dismiss under Rule 12(b)(6)." *Ritchie*, 342 F.3d at 908.

C. The Decisions Below Conflict with the Plain Language of the Federal Rules of Civil Procedure.

1. The Rules do not permit consideration, on a motion to dismiss, of documents not attached as exhibits to the complaint.

"A copy of a written instrument *that is an exhibit to a pleading* is a part of the pleading for all purposes." Fed. R. Civ. P. 10(c) (emphasis added). The Rules contain no provision for a court to consider as part of the pleadings any document that is *not* attached as an exhibit. Thus, for purposes of a motion under Rule 12(b)(6), a court may consider only the complaint itself and any attached written instruments. "If, on a motion under Rule 12(b)(6) ..., matters outside the pleadings are presented to and not excluded by the court, the motion must be treated as one for summary judgment under Rule 56. All parties must be given a

reasonable opportunity to present all the material that is pertinent to the motion." Fed. R. Civ. P. 12(d).

Though the plain language of Rule 10(c) does not allow the district court to consider as "part of the pleading" any document not attached to the complaint, many lower courts have grafted into the Rule an extra-textual provision allowing the defendant to submit with its motion documents that are not attached to but are relied upon by the complaint. *See, e.g.*, *Venture Assocs. Corp. v. Zenith Data Sys. Corp.*, 987 F.2d 429, 431 (7th Cir. 1993) ("A plaintiff is under no obligation to attach to her complaint documents upon which her action is based, but a defendant may introduce certain pertinent documents if the plaintiff failed to do so. Documents that a defendant attaches to a motion to dismiss are considered part of the pleadings if they are referred to in the plaintiff's complaint and are central to her claim." (citations omitted)). The courts condone this practice under the reasoning that the "plaintiff should not so easily be allowed to escape the consequences of its own failure" to attach such documents to the complaint. *Cortec Indus., Inc. v. Sum Holding L.P.*, 949 F.2d 42, 47 (2d Cir. 1991); *see also, e.g.*, *Pension Benefit Guar. Corp. v. White Consolidated Indus., Inc.*, 998 F.2d 1192, 1196 (3d Cir. 1993) ("Otherwise, a plaintiff with a legally deficient claim could survive a motion to dismiss simply by failing to attach a dispositive document on which it relied."). Lower courts have not suggested that the Rules actually permit this practice.

2. The Rules do not permit consideration of documents other than "written instruments."

Even if a federal court may consider documents that are not attached to a pleading, consideration should be limited to documents that are "written instrument[s]" which might properly be attached as "an exhibit to a pleading" under Rule 10(c). "A 'written instrument' is a document evidencing legal rights or duties or giving formal expression to a legal act or agreement, such as a deed, will, bond, lease, insurance policy or security agreement." *Murphy v. Cadillac Rubber & Plastics, Inc.*, 946 F. Supp. 1108, 1115 (W.D.N.Y. 1996) (declining to consider affidavits, letters, and unsigned contract) (citing *Black's Law Dictionary* 801, 1612 (6th ed. 1990); *Webster's Third New Int'l Dictionary* 1172 (1986)). Thus, "the types of exhibits incorporated within the pleadings by Rule 10(c) consist largely of documentary evidence, specifically, contracts, notes, and other writings on which a party's action or defense is based." *Rose*, 871 F.2d at 340 (quotation marks, citation, alterations omitted); *see also, e.g.*, *Global Network Commc'ns, Inc. v. City of New York*, 458 F.3d 150, 157 (2d Cir. 2006) ("In most instances where this exception is recognized, the incorporated material is a contract or other legal document containing obligations upon which the plaintiff's complaint stands or falls ....").

"[E]xhibits containing largely evidentiary material typically do not fall within Rule 10(c)'s category of 'written instruments.'" *Montgomery v. Buege*, No. CIV. 08-385 WBS KJM, 2009 WL 1034518, at *3 (E.D. Cal. April 16, 2009) (striking evidentiary documents from pleadings); *see generally* 5A Wright & Miller, *supra*,

§ 1327 ("[L]engthy or numerous exhibits containing extraneous or evidentiary material should not be attached to the pleadings."). Although a document may be critical to proof of the plaintiff's claim and may be discussed at length in the plaintiff's complaint, this does not allow the court to consider the document as a "written instrument" on a motion to dismiss. In declining to consider a DVD recording of events at issue, one court explained:

> [T]he Concert DVD is not central to Plaintiffs' case in the sense that a purchase and sale agreement is central to an action based upon the contract, or that a pension plan is central to an action to recover assets under the plan. Although the Concert DVD may be important to Plaintiffs' case insofar as it represents a result of the alleged wiretapping, the Concert DVD is not determinative of Plaintiffs' claims necessarily.... [T]he Concert DVD does not define the rights and obligations of the parties. Thus, as opposed to being a "written instrument" for the purposes of Rule 10(c), the Court concludes that the DVD is the sort of lengthy exhibit containing extraneous or evidentiary material that should not be attached to the pleadings.

Bowens v. Aftermath Entertainment, 254 F. Supp. 2d 629, 639-40 (E.D. Mich. 2003) (quotation marks and citations omitted). Similarly, here, even though the appraisal report might ultimately be a key piece of evidence in determining what Deloitte-USA did in performing its appraisal, and the AICPA guide in determining auditing standards, these documents are not "central," "dispositive," or "integral" to – nor do

they form the basis of – Plaintiffs' claims because they do not determine legal rights or duties among the parties.

The narrow exception where courts have considered certain documents as part of the complaint "is not intended to grant litigants license to ignore the distinction between motions to dismiss and motions for summary judgment." *Levenstein*, 164 F.3d at 347. To allow consideration of evidentiary documents on a motion to dismiss, as the district court did below, "blur[s] the distinction between summary judgment and dismissal for failure to state a claim upon which relief could be granted." *Rose v. Bartle*, 871 F.2d 331, 340 (3d Cir. 1989). This Court should grant certiorari to put an end to this practice.

3. The Rules do not permit consideration of documents for the truth of matters asserted.

Because on a motion to dismiss the Rules permit the consideration only of "written instruments" – and do not permit the consideration of evidentiary documents – it follows that documents may be considered only for the legal effect of statements made. It is improper, on a motion to dismiss, to consider a document for the truth of assertions therein. The district court acknowledged this point in its decision – though it did not adhere to this principle. *See* App. 61a n.123; *cf. Gen. Elec. Capital Corp. v. Lease Resolution Corp.*, 128 F.3d 1074, 1084 (7th Cir. 1997) ("district court erred in relying on a private settlement document for the truth of facts asserted therein"); *Lovelace v. Software Spectrum, Inc.*, 78 F.3d 1015, 1017-18 (5th Cir. 1996) ("Such documents should be

considered only for the purpose of determining what statements the documents contain, not to prove the truth of the documents' contents."); *Hal Roach Studios, Inc. v. Richard Feiner & Co.*, 896 F.2d 1542, 1550 (9th Cir. 1990) (district court erred in relying on S-1 registration statement to establish truth of assertions therein); *Shopko*, 2002 WL 32003318, at *2 (cases considering SEC filings "did not consider the SEC filings for the truth of the defendants' disclosures asserted therein; they considered them only to determine what disclosures the defendants made").

D. Application of the Incorrect Standard Caused the District Court to Err.

In its opinion dismissing Plaintiffs' claims, the district court should not have considered – for any purpose – the two appraisal reports or the AICPA guide. Though they were quoted or referred to in the complaints, these documents are not central to Plaintiffs' claims, do not define any legal rights or obligations, and cannot fairly be characterized as "written instruments" under Rule 10(c).

More importantly, these documents should not have been relied upon for the truth of their assertions. Despite the district court's acknowledgement that it may not consider extraneous documents for their truth, this was not the rule it followed. The court assumed the truth of Deloitte-USA's assertions in its appraisal report that there had been a substantial investment in the facilities being appraised, that it was not feasible to perform the appraisal under the cost method, and that Deloitte-USA had considered and rejected the market-comparable approach for proper reasons. *See* App. 61a-65a. But Plaintiffs'

complaints specifically allege these statements were false.

The district court also assumed the truth of the AICPA audit guide with respect to the requirements of GAAS; further, the court drew its own inferences as to what GAAS requires, notwithstanding Plaintiffs' contrary allegations. *See* App. 71a-72a. This was wholly improper. AICPA pronouncements are not a legal code subject to judicial interpretation but rather are a quintessential factual matter. They are general guidelines subject to differing interpretations and unwritten rules of practice. When auditing standards are at issue, they are almost invariably the subject of conflicting expert testimony. This Court has observed with respect to generally accepted accounting principles ("GAAP"):

> GAAP is not [a] lucid or encyclopedic set of pre-existing rules .... Far from a single-source accounting rulebook, GAAP encompasses the conventions, rules, and procedures that define accepted accounting practice at a particular point in time. GAAP changes and, even at any one point, is often indeterminate.... There are 19 different GAAP sources, any number of which might present conflicting treatments of a particular accounting question. When such conflicts arise, the accountant is directed to consult an elaborate hierarchy of GAAP sources to determine which treatment to follow.

Shalala v. Guernsey Mem'l Hosp., 514 U.S. 87, 101 (1995) (citations, quotation marks, and alterations omitted); *see also id.* at 100 ("Financial accounting is not a science. It addresses many questions as to which

the answers are uncertain and is a process that involves continuous judgments and estimates." (quotation marks and alterations omitted)). These statements are equally true with respect to GAAS.

By considering documents outside the complaint, the district court dove headfirst into messy factual issues that should be resolved by a jury. What the district court did, regarding the statements in these documents as true and drawing inferences against Plaintiffs, would not have been proper on a summary judgment motion, much less on a motion to dismiss.

CONCLUSION

For the reasons stated above, this Court should grant certiorari on both questions presented.

Respectfully Submitted,

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APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

No. 07-4103-cv(L), 07-4093-cv

[Decided February 17, 2009]

PRESENT:

JOSÉ A. CABRANES,
RICHARD C. WESLEY,
Circuit Judges,
EDWARD R. KORMAN,*
District Judge.

G. PETER PAPPAS, AS THE PLAN ADMINISTRATOR OF THE PLAN LIQUIDATION OF PARMALAT-USA CORPORATION, GERALD K. SMITH, AS LITIGATION TRUSTEE OF THE FARMLAND DAIRIES LLC LITIGATION TRUST,

Plaintiffs-Appellants,

v.

BANK OF AMERICA CORPORATION, BANK OF AMERICA, N.A, BANK OF AMERICA NATIONAL

---

* The Honorable Edward R. Korman, of the United States District Court for the Eastern District of New York, sitting by designation.

TRUST & SAVINGS ASSOCIATION, BANC OF AMERICA SECURITIES LLC, BANC OF AMERICA SECURITIES LIMITED, BANKAMERICA INTERNATIONAL LIMITED, GRANT THORNTON INTERNATIONAL, GRANT THORNTON, LLP, GRANT THORNTONSPA, NOW KNOWN AS ITALAUDIT SPA DELOITTE & TOUCHE USA, LLP, DELOITTE & TOUCHE LLP, DELOITTE & TOUCHE TOHMATSU, DELOITTE & TOUCHE, SPA, BANCA NAZIONALE DEL LAVARO, SPA, CREDIT SUISSE INTERNATIONAL, FORMERLY KNOWN AS CREDIT SUISSE FIRST BOSTON INTERNATIONAL, CREDIT SUISSE SECURITIES (EUROPE) LIMITED, FORMERLY KNOWN AS CREDIT SUISEE FIRST BOSTON (EUROPE) LIMITED, CREDIT SUISSE, FORMELY KNOWN AS CREDIT SUISSE FIRST BOSTON, BANCA INTESA SPA,

Defendants-Appellees.[**]

SUMMARY ORDER

[List of Counsel omitted in this Appendix]

Appeal from a judgment of the United States District Court for the Southern District of New York (Lewis A. Kaplan, *Judge*).

UPON CONSIDERATION WHEREOF, IT IS HEREBY ORDERED, ADJUDGED, AND DECREED that the judgment of the District Court is **AFFIRMED.**

[**] The Clerk of Court is directed to amend the official caption in this case to conform to the listing of the parties above.

Plaintiffs appellants Gerald K. Smith, litigation trustee of Farmland Dairies LLC Litigation Trust ("Farmland"), and Peter G. Pappas, plan administrator of the Plan of Liquidation of Parmalat-USA Corporation ("Parmalat USA") (jointly, "plaintiffs"), appeal August 23, 2007 and September 5, 2007 judgments of the District Court dismissing their suits against defendant banks and accounting firms. Both Farmland and Parmalat USA are bankrupt subsidiaries of international dairy conglomerate Parmalat S.p.A., which filed for bankruptcy in Italy in 2003. Plaintiffs' numerous claims against defendants are substantially the same. The only relevant difference between the two suits is that the operative complaint in *Smith v. Bank of America,* 06 Civ. 0383 (S.D.N.Y.), named Banca Intesa as a defendant and asserted a cause of action against certain other defendants for aiding and abetting a fraudulent conveyance, while the complaint in *Pappas v. Bank of America,* 06 Civ. 3109 (S.D.N.Y), did not. Our decision, like the judgments and orders of the District Court, applies to both causes.

On appeal, plaintiffs argue that the District Court erred in applying the pleading standards of Federal Rules of Civil Procedure 8 and 9(b) to dismiss their Second Amended Complaint ("SAC"). They contend further that the District Court erred in holding that their SAC did not adequately plead (1) an injury proximately caused by GT Italy or Deloitte Italy, (2) an injury proximately caused by defendant banks, (3) fraudulent intent on the part of Deloitte USA, (4) Deloitte USA's vicarious liability for Deloitte Italy's actions, or (5) damages as a result of any defendant's misconduct. Finally, they argue that the District Court abused its discretion in not granting plaintiffs leave to

file a Third Amended Complaint. We assume the parties' familiarity with the facts and procedural history of this case.

We review *de novo* the District Court's grant of defendants' motions to dismiss under Federal Rule of Civil Procedure 12(b)(6). *See, e.g., Burch v. Pioneer Credit Recovery, Inc.*, 551 F.3d 122, 124 (2d Cir. 2008). We construe plaintiffs' complaints liberally, "accepting all factual allegations as true, and drawing all reasonable inferences in the plaintiff's favor." *Id.* We may affirm the District Court only if the plaintiff fails to provide factual allegations sufficient "'to raise a right to relief above the speculative level.'" *Goldstein v. Pataki*, 516 F.3d 50, 56 (2d Cir. 2008) (quoting *Bell Atl. Corp. v. Twombly*, 127 S. Ct. 1955, 1965 (2007)).

We agree with Judge Kaplan that, as plaintiffs have failed to allege that "any of the defendants, with the exception of Deloitte USA, had any connection to [Farmland or Parmalat USA] or even knew about, assisted, or otherwise participated in" the allegedly fraudulent transactions at issue, "let alone the looting of the proceeds" from those transactions by Parmalat officers. *In re Parmalat Sec. Litig.*, 501 F. Supp. 2d 560, 579 (S.D.N.Y. 2007). The District Court correctly concluded that plaintiffs failed to allege that any of Deloitte's member firms acted as an agent of, or a joint venturer with, Deloitte USA. *See id.* at 591. We agree that "[a]s plaintiffs have failed adequately to allege Deloitte USA's knowledge that Parmalat insiders were committing fraud, they have failed to allege that it was reasonably foreseeable to Deloitte USA that its conduct eventually would result in the looting of Farmland's assets." *Id.* We therefore hold that the

District Court properly dismissed plaintiffs' claims against each defendant.

Finally, we turn to plaintiffs' contention that the District Court erred in denying their motions to file a Third Amended Complaint. Rule 15(a) of the Federal Rules of Civil Procedure states that "leave [to amend] shall be freely given when justice requires." We review the District Court's decision to deny plaintiffs' leave to amend their complaints for abuse of discretion. *See, e.g., McCarthy v. Dun & Bradstreet Corp.*, 482 F.3d 184, 200 (2d Cir. 2007). "A district court has discretion to deny leave for good reason, including futility, bad faith, undue delay, or undue prejudice to the opposing party." *Id.*

We agree with Judge Kaplan that the problems with the SAC "should have been apparent to plaintiffs even before they filed their original complaints." *In re Parmalat Sec. Litig.*, 1:04-md-01653-LAK-HBP, slip order at 3 (S.D.N.Y. Sept. 4, 2007). We also agree that "this [was] an exceptionally complex multidistrict proceeding. These plaintiffs, with their unjustifiably verbose pleadings, . . . contributed more than their share to its extraordinary cost and burden." *Id.* We therefore hold that the District Court properly denied plaintiffs an opportunity to file a Third Amended Complaints in these "dubious cases." *Id.*

Accordingly, the August 23, 2007 and September 5, 2007 judgments of the District Court are AFFIRMED, substantially for the reasons stated by Judge Kaplan in his careful and thoughtful opinion of August 8, 2007, *see In re Parmalat Sec. Litig.*, 501 F. Supp. 2d 560 (S.D.N.Y. 2007), and his memorandum and order

of September 4, 2007, *see In re Parmalat Sec. Litig.*, 1:04-md-01653-LAK-HBP (S.D.N.Y. Sept. 4, 2007).

FOR THE COURT
Catherine O'Hagan Wolfe, Clerk of Court

By _____

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MASTER DOCKET
04 MD 1653 (LAK)

[Filed September 5, 2007]

In re PARMALAT SECURITIES LITIGATION	)
	)
This document relates to: 06 Civ. 0383, 06 Civ. 3109	)
	)

JUDGMENT

Whereas defendants having moved to dismiss the second amended complaints in both actions; the Court having granted the motions and plaintiffs Smith and Pappas having moved for reconsideration or, alternatively, for leave to amend; and the matter having come before the Honorable Lewis A. Kaplan, United States District Judge, and the Court, on August 8, 2007 and September 4, 2007, having rendered its Opinion and Memorandum and Order, respectively, granting the motions of Deloitte USA, DTT, Deloitte Italy, GTI, GT USA, the Bank of America Defendants, the Credit Suisse Defendants, and BNL to dismiss the second amended complaints of Smith and Pappas in their entirety, and granting Banca Intesta's motion to dismiss Smith's second amended complaint in its entirety as well, and denying

plaintiffs' motion for reconsideration or alternatively, leave to amend in all respects, and directing the Clerk of the Court to enter final judgment dismissing these actions, it is,

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Opinion and Memorandum and Order dated August 8, 2007 and September 4, 2007, respectively, the motions of Deloitte USA, DTT, Deloitte Italy, GTI, GT USA, the Bank of America Defendants, the Credit Suisse Defendants, and BNL to dismiss the second amended complaints of Smith and Pappas are granted in their entirety, and Banca Intesa's motion to dismiss Smith's second amended complaint is granted in its entirety as well; and plaintiffs' motion for reconsideration or alternatively, for leave to amend is denied in all respects; accordingly, final judgment is entered dismissing these actions.

Dated: New York, New York
September 5, 2007

J. MICHAEL McMAHON
Clerk of Court

BY: /s/ _____
Deputy Clerk

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MASTER DOCKET
04 MD 1653 (LAK)

[Filed September 4, 2007]

In re PARMALAT SECURITIES LITIGATION	)
	)
This document relates to: 06 Civ. 0383, 06 Civ. 3109	)
	)

MEMORANDUM AND ORDER

LEWIS A. KAPLAN, *District Judge.*

Plaintiffs Smith and Pappas move for reconsideration of the Court's decision granting defendants' motions to dismiss their Second Amended Complaints ("SAC"s)[1] or, alternatively, for leave to amend. The motion is without merit.

[1] *In re Parmalat Secur. Litig.*, MDL No. 1653, 2007 WL 2263893 (S.D.N.Y. Aug. 8, 2007).

The Motion for Reconsideration

Plaintiffs first argue that the Court "incorrectly stated the standards for pleading."[2] The Court cannot, however, discern from their memorandum why they believe this is so. The relevant portion of the document begins by noting that the SACs were prepared before *Bell Atlantic Corp. v. Twombly*[3] and its progeny,[4] which the Court relied upon, had been decided, but then fails to argue that the Court misapprehended the standard that now governs. Plaintiffs have failed to show that the Court overlooked any material matters or controlling decisions. Nothing further need be said on this point save that the Court would have dismissed the SACs for substantially the same reasons even before *Twombly*.

Plaintiffs next argue that they sufficiently pleaded loss causation under *Bloor v. Carro, Spanbock, Londin, Rodman & Fass*.[5] The significance and import of *Bloor*, however, were briefed extensively on the motions to dismiss. Plaintiffs have said nothing that persuades me that I misapprehended it or otherwise erred.

Accordingly, the motion for reconsideration will be denied.

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[2] Def. Mem. i.

[3] 127 S.Ct. 1955 (2007).

[4] Def. Mem. 2-7.

[5] 754 F.2d 57 (2d Cir. 1985).

Leave to Amend

These cases were filed long after the initial U.S. complaints relating to the collapse of Parmalat. Plaintiffs here therefore had the benefit of many prior pleadings by other plaintiffs and, indeed, of several rulings on motions to dismiss in other cases before they filed their original complaints. Moreover, shortly after filing their original complaints, both filed amended complaints. That in No. 06 Civ. 0383 was 342 pages long, that in No. 06 Civ. 3109 a mere 340 pages in length.

In August 2006, the Court granted a motion by defendants in No. 06 Civ. 0383 to dismiss the amended complaint in that case, principally on the ground that it did not comply with the short and plain statement requirement of Fed. R. Civ. P. 8(a). In so doing, it noted that it was "readily apparent that [the pleading] was cut and pasted from other pleadings in other Parmalat cases without necessary regard to what is relevant to this case, the consistency of the other pleadings, and any consideration for anyone who has to read it." Order, Aug. 16, 2006, at 2.

Plaintiffs then filed SACs in both of these cases. They pared the complaints down to the 140-160 page range. But they did little to cure the other problems.

It of course is a commonplace that leave to amend should be freely granted, but that principle has its limits. Bad faith, undue delay, repeated failure to cure deficiencies by amendments previously allowed, undue prejudice and other factors may warrant denial of

leave.[6] And this is a case in which further leave to amend would be a step too far.

To begin with, plaintiffs have had more than sufficient opportunity to file sufficient complaints. The SACs of course are their third attempts to plead their claims. Moreover, as noted, these three attempts have had the benefit of extensive pleadings by other parties as well as rulings by the Court on other motions in other cases. I see no excuse for allowing the plaintiffs more than the three strikes they already have had.

Second, the problems that resulted in the dismissal of the SACs should have been apparent to the plaintiffs even before they filed their original complaints.

Third, plaintiffs have tendered no proposed third amended complaints and have not even begun to suggest how they think they might cure the deficiencies in the SACs.

Finally, this is a large and exceptionally complex multidistrict proceeding. These plaintiffs, with their unjustifiably verbose pleadings, have contributed more than their share to its extraordinary cost and burden. I see no sufficient reason for these belatedly filed and dubious cases to continue to complicate this proceeding.

Accordingly, plaintiffs' motion for reconsideration or, alternatively, leave to amend is denied in all

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[6] *E.g., Rachman Bag Co. v. Liberty Mut. Ins. Co.*, 46 F.3d 230, 234-35 (2d Cir. 1995).

respects. The Clerk shall enter final judgment dismissing these actions.

SO ORDERED.

Dated: September 4, 2007

/s/ Lewis A. Kaplan
Lewis A. Kaplan
United States District Judge

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MASTER DOCKET
04 MD 1653 (LAK)

[Filed August 23, 2007]

In re PARMALAT SECURITIES LITIGATION	)
	)
This document relates to: 06 Civ. 0383, 06 Civ. 3109	)
	)

JUDGMENT

Defendants having moved to dismiss the second amended complaints in both actions, and the matter having come before the Honorable Lewis A. Kaplan, United States District Judge, and the Court, on August 8, 2007, having rendered its Opinion granting the motions of Deloitte USA, DTT, Deloitte Italy, GTI, GT USA, the Bank of America Defendants, the Credit Suisse Defendants, and BNL to dismiss the second amended complaints of Smith and Pappas in their entirety, and granting Banca Intesta's motion to dismiss Smith's second amended complaint in its entirety as well, it is,

ORDERED, ADJUDGED AND DECREED: That for the reasons stated in the Court's Opinion dated August 8, 2007, the motions of Deloitte USA, DTT,

Deloitte Italy, GTI, GT USA, the Bank of America Defendants, the Credit Suisse Defendants, and BNL to dismiss the second amended complaints of Smith and Pappas are granted in their entirety, and Banca Intesa's motion to dismiss Smith's second amended complaint is granted in its entirety as well.

Dated: New York, New York
August 23, 2007

J. MICHAEL McMAHON
Clerk of Court

BY: /s/_____
Deputy Clerk

APPENDIX E

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

MASTER DOCKET
04 MD 1653 (LAK)

[Filed August 8, 2007]

In re PARMALAT SECURITIES LITIGATION	)
	)
This document relates to: 06 Civ. 0383, 06 Civ. 3109	)
	)

OPINION

[List of Counsel omitted in this Appendix]

LEWIS A. KAPLAN, *District Judge*.

International dairy conglomerate Parmalat S.p.A. and its affiliates ("Parmalat") collapsed in scandal and filed for bankruptcy in Italy in late 2003. These actions are brought on behalf of the successors of two bankrupt Parmalat subsidiaries against a number of banks and accounting firms principally for helping conceal Parmalat's true financial condition, thus causing the subsidiaries to incur debt in reliance on misrepresentations of Parmalat's financial health. Before the Court are defendants' motions to dismiss the second amended complaints in both actions.

Facts

The complaints in these two actions are substantially the same. The only relevant differences are that the complaint in *Smith v. Bank of America*[1] names Banca Intesa as a defendant and asserts a cause of action against certain other defendants for aiding and abetting a fraudulent conveyance, while the complaint in *Pappas v. Bank of America*[2] does not. Accordingly, the following allegations are drawn from both complaints unless otherwise indicated.

I. The Parties

A. Plaintiffs

Parmalat USA Corp. ("Parmalat USA") was a wholly owned subsidiary of Parmalat. It had no operations or employees of its own, but was the sole owner of Farmland Dairies LLC ("Farmland"), which was in the business of processing, selling, and distributing dairy products in the United States.[3] According to the complaints, both Parmalat USA and

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[1] 06 Civ. 0383.

[2] 06 Civ. 3109.

[3] *Pappas v. Bank of Am. Corp.*, 06 Civ. 3109, docket item 6 (second amended complaint), ¶¶ 1-2 [hereinafter, *Pappas* SAC]; *Smith v. Bank of Am. Corp.*, 06 Civ. 0383, docket item 157 (second amended complaint), ¶¶ 1-2 [hereinafter, *Smith* SAC].

For purposes of this Opinion, the Court will cite to "*Pappas* SAC" where the complaints are duplicative, as parallel citations would be cumbersome. It cites to "*Smith* SAC" when referencing allegations found only in that complaint.

Farmland (the "Companies") were insolvent and completely financially dependent on Parmalat.[4]

The Companies filed for bankruptcy in this district on February 24, 2004, following Parmalat's collapse.[5] On March 10, 2004, the bankruptcy court confirmed a liquidation plan for Parmalat USA and a modified reorganization plan for Farmland. Plaintiff G. Peter Pappas was appointed the administrator of Parmalat USA's Plan of Liquidation. Plaintiff Gerald K. Smith was appointed the litigation trustee of Farmland Dairies LLC Litigation Trust.[6]

B. Defendants

1. The Deloitte Defendants

Deloitte Touche Tohmatsu ("DTT") is a Swiss association headquartered in New York and the umbrella firm for the international accounting enterprise commonly known as "Deloitte."[7]

Deloitte & Touche USA LLP and its subsidiary, Deloitte & Touche LLP (collectively, "Deloitte USA") are Delaware limited liability partnerships. Together they constitute the United States member firm of the

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[4] *See Pappas* SAC ¶¶ 102-108.

[5] *Id.* ¶ 3.

[6] *Id.* ¶ 11; *Smith* SAC ¶ 11.

[7] *Pappas* SAC ¶ 42.

Deloitte organization.[8] Deloitte USA audited Parmalat USA's financial statements from 1999 to 2002.[9]

Deloitte & Touche, S.p.A. ("Deloitte Italy") is an Italian limited liability entity and the Italian member firm of DTT.[10] It audited Parmalat's consolidated financial statements from 1999 to 2002.[11]

2. The Grant Thornton Defendants

Grant Thornton International ("GTI") is an Illinois corporation headquartered in London and the umbrella organization for Grant Thornton entities throughout the world. Grant Thornton LLP ("GT USA") is an Illinois limited liability partnership and the United States member firm of GTI. Grant Thornton S.p.A. ("GT Italy") is an Italian limited liability entity and the Italian member firm of GTI.[12] GT Italy audited the financial statements of Parmalat's off-shore subsidiary, Bonlat Financing Ltd. ("Bonlat") from 1999 to 2002.[13]

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[8] *Id.* ¶¶ 43-44.

[9] *Id.* ¶ 71.

[10] *Id.* ¶ 45.

[11] *Id.* ¶¶ 161
DTT, Deloitte USA, and Deloitte Italy are referred to collectively herein as the "Deloitte Defendants."

[12] *Id.* ¶¶ 35-37.

[13] *Id.* ¶¶ 311.
GTI, GT USA, and GT Italy are referred to collectively herein as the "Grant Thornton Defendants."

3. The Bank of America Defendants

Bank of America Corp. ("BA Corp.") is a Delaware corporation and the parent of Bank of America, N.A. ("BANA"), a national banking association based in North Carolina and successor of Bank of America National Trust & Savings Association ("BANTSA"). Banc of America Securities Ltd. ("BAS Ltd.") is a United Kingdom limited liability investment bank and BANA's wholly owned subsidiary. Its predecessor was Bank of America International Ltd. (BAD. Banc of America Securities LLC ("BAS LLC"), also a subsidiary of BA Corp., is a Delaware limited liability investment bank and brokerage firm based in North Carolina.[14]

4. The Credit Suisse Defendants

While the complaints are not entirely clear, it appears that there are three Credit Suisse defendants.

Credit Suisse Group ("CSG") is a Swiss global financial services company with a branch office in New York City. According to the complaints, an entity called Credit Suisse First Boston ("CSFB") was its wholly owned subsidiary and investment banking and asset management arm until 2005 when it merged with Credit Suisse ("CS"), which the complaints describe as CSG's private banking division. The complaints appear to name CS as a defendant. If, in

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[14] *Id.* ¶¶ 13-22.
BA Corp., BANA, BANTSA, BAS Ltd., BAS LLC, and BAI are referred to collectively herein as the "Bank of America Defendants."

fact, that was the intention and if, as plaintiffs suggest, CS is an unincorporated division of CSG, CSG would be a defendant. The Court notes, however, that CSG's Report on Form 6-K for August 2007 describes CS as a wholly-owned subsidiary. In addition, counsel for the Credit Suisse defendants have appeared on behalf of CS rather than CSG. In consequence, the Court concludes that the plaintiffs sued CS, not CSG. In view of the outcome of these motions, however, any uncertainty ultimately is immaterial.

The other two Credit Suisse defendants are Credit Suisse First Boston International ("CSFBI"), a London-based bank, and Credit Suisse Securities (Europe) Limited ("CSSEL"), a London-based broker-dealer.[15]

5. Banca Nazionale

Banca Nazionale del Lavoro S.p.A. ("BNL") is an Italian banking conglomerate. It has branches in the United States, including New York and Chicago, and describes itself as one of the world's 100 largest banks. BNL's subsidiary, Ifitalia S.p.A. ("Ifitalia"), is an Italian bank and factoring company.[16]

6. Banca Intesa

Smith's complaint names also Banca Intesa ("Intesa"), one of Italy's largest banking companies, which provides a variety of commercial banking

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[15] *Id.* ¶¶ 29-32.
CS, CSFBI, and CSSEL are referred to collectively herein as the "Credit Suisse Defendants."

[16] *Id.* ¶ 34. Ifitalia is not named as a defendant.

services.[17] Its subsidiary, Nextra Investment Management SGT ("Nextra"), serves as Intesa's asset management and investment banking arm.[18]

II. The Alleged Wrongdoing

The complaints are long, rambling, repetitious, and disorganized.[19] Their gist, however, can be summed up as follows.

Plaintiffs allege that the Companies were insolvent and completely financially dependent on Parmalat at all relevant times.[20] For example, the notes to

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[17] *Smith SAC* ¶¶ 37-38.

[18] *Id.* ¶¶ 503, 506. Nextra is not named as a defendant.

[19] For example, Smith's second amended complaint is 156 pages and 617 numbered paragraphs. While this is a substantial improvement over the first amended complaint, which was 342 pages long and contained 1309 numbered paragraphs, it still is unnecessarily long. In addition, where allegations concerning a particular topic could have been placed in a single section, plaintiffs instead have spread them among numerous, disparate sections, leaving it to the Court to consolidate relevant allegations to get a coherent picture of the alleged wrongdoing and the relationships among the parties. *See, e.g.*, ¶¶ 47-56, 266-315 (describing Deloitte Defendants and their relationships to one another); *id.* ¶¶ 215-223, 322-343 (alleging wrongdoing related to Bonlat). Moreover, the complaints often lump defendants together, making it unclear which particular defendants are the subject of certain allegations and forcing the Court, where possible, to rely on context to understand plaintiffs' precise meaning. *See, e.g.*, *id.* ¶ 171 (referring to "Deloitte" generally without specifying particular Deloitte entity).

[20] *See Pappas* SAC ¶¶ 102-108, 156.

Parmalat USA's consolidated financial statements for 2002 stated that the company's ability to maintain its then-current debt arrangement, obtain additional financing from third-party lenders, and continue as a going concern was dependent on Parmalat's ability to guarantee Parmalat USA's debt to third parties and Parmalat's forbearance from calling debts owed to it by Parmalat USA.[21]

Because of this dependence on Parmalat, plaintiffs claim, certain "innocent decision makers" at the Companies relied on representations that Parmalat was financially healthy in (1) causing Parmalat USA to incur more than $20 million in debt guaranteed by Parmalat,[22] and (2) causing Farmland to take out a loan in the form of a sale-leaseback transaction, whereby it transferred its dairy processing plants and equipment to a third party and leased them back under leases guaranteed by Parmalat.[23]

Plaintiffs allege, however, that Parmalat in fact was in financial ruin when the Companies entered into these transactions. Certain of Parmalat's officers, directors, and other employees allegedly had looted the company for years and fraudulently concealed the company's true financial condition in its financial statements.[24] Plaintiffs allege that the Companies therefore incurred debt that they were unable to repay

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[21] *Id.* ¶ 106.

[22] *Id.* ¶¶ 150-156.

[23] *Id.* ¶¶ 7, 224.

[24] *E.g.*, *id.* ¶ 4.

once Parmalat collapsed in 2003, thus deepening their insolvency. In addition, the proceeds of the sale-leaseback transaction allegedly were looted by Parmalat insiders.[25]

According to plaintiffs, the innocent decision makers would have prevented the Companies from incurring these liabilities in the first instance, reported the fraudulent acts being committed by Parmalat's insiders, and filed for bankruptcy at an earlier date if they had known the truth about Parmalat's financial condition.[26]

Defendants are charged principally with assisting the Parmalat fraud or otherwise with being complicit in a scheme to hide Parmalat's financial condition. The allegations of defendants' wrongdoing may be divided into three categories.

A. Misleading Parmalat Financial Statements

The first includes claims that Deloitte Italy and GT Italy helped Parmalat insiders misrepresent Parmalat's financial condition in financial statements. They allegedly did so by (1) failing to reveal in their audit reports that Bonlat was booking fictitious sales to boost Parmalat's reported revenues, and that Bonlat's sole purported asset, a $4.9 billion bank account, did not exist,[27] (2) participating in a scheme with Parmalat's insiders to reclassify improperly

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[25] *Id.* ¶¶ 6-8.

[26] *See, e.g., id* ¶ 159.

[27] *Id.* ¶¶ 195-202; 310-328.

"Parmalat's growing debts to third parties as obligations owed by one Parmalat entity to another,"[28] and (3) deliberately preventing DTT's Maltese member firm ("Deloitte Malta"), which audited Bonlat's parent, Parmalat Capital Finance ("PCF"), from receiving Bonlat's audited financial statements for the years 2001 and 2002, thus preventing Deloitte Malta from completing its audit work on PCF's 2002 financial statements and blowing the whistle on the Bonlat fraud.[29]

The complaints allege that Deloitte Italy further assisted the fraud by (4) certifying Parmalat's 2002 financial statements without having received certification of PCF's financial statements for that year,[30] (5) failing to reveal in its audit reports that reimbursement credits issued by Parmalat to its subsidiaries, which the subsidiaries booked as reductions in costs and expenses, were uncollectible,[31] and (6) failing to ensure that a $26.5 million write-down of Parmalat USA's goodwill in 2002 "flowed through" to Parmalat's financial statements.[32]

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[28] *Id.* ¶ 183.

[29] *Id.* ¶¶ 207-215.

[30] *Id.* ¶ 215.

[31] *Id.* ¶¶ 186-190, 193.

[32] *Id.* ¶ 191.

B. Fraudulent Transactions

The second category of allegations includes claims that certain defendants engaged in transactions that permitted Parmalat insiders to misrepresent the company's financial health.

Plaintiffs allege that the Bank of America and Credit Suisse Defendants structured or otherwise participated in fraudulent transactions designed to conceal Parmalat's debt,[33] and that BNL and Ifitalia repeatedly paid Parmalat cash in exchange for assignment of receivables that both parties knew were bad, thus permitting Parmalat to record as assets what essentially were loans from BNL.[34] These allegations are substantially similar to those described in the Court's earlier opinions in related matters,[35] familiarity with which is assumed, and need not be recounted here.

In addition, Smith alleges that Intesa assisted Parmalat's insiders in fraudulently securing financing through the use of a company called Wishaw Trading

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[33] *See generally id.* ¶¶ 359-437 (allegations against the Bank of America Defendants), 440-454 (allegations against the Credit Suisse Defendants).

[34] *See generally id.* ¶¶ 455-474.

[35] *See In re Parmalat Sec. Litig.*, 412 F. Supp. 2d 392, 396-399 (S.D.N.Y. 2006) (describing allegations against the Bank of America Defendants); *In re Parmalat Securities Litigation*, 376 F. Supp. 2d 472, 489-90 (S.D.N.Y. 2005) (describing allegations against the Credit Suisse Defendants); *id.* at 488-89 (describing allegations against BNL and Ifitalia).

S.p.A. ("Wishaw").[36] Although Smith does not so allege, he implies that Parmalat or its employees somehow controlled Wishaw.[37] According to Smith, Parmalat insiders "used" Wishaw to manufacture fictitious promissory notes, purportedly representing trade debt owed to Intesa, which Intesa then endorsed and sold to third parties, thus acting as a "broker/banker of fraudulently obtained loans." The purpose of the transaction, Smith claims, was to raise money to "prop up Parmalat's ailing Brazilian operations and to improperly funnel money to" Parmalat's corrupt insiders.[38]

Smith alleges also that in June 2003, Nextra purchased an entire € 300 million bond issue of Parmalat Finance Corporation B.V., which it resold within a few months for a substantial profit, despite knowing of Parmalat's "disastrous financial condition." According to Smith, this transaction "artificially propped up Parmalat and concealed Parmalat's true financial condition."[39]

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[36] *Smith* SAC ¶ 489.

[37] Pleadings in related cases allege that Wishaw is a Uruguayan shell entity controlled by the Tanzi family, the same family that founded and controlled Parmalat. *See In re Parmalat Sec. Litig.*, 383 F. Supp. 2d 587, 591 (S.D.N.Y. 2005). Smith states as much in his memorandum in opposition to Intesa's motion to dismiss. *See* Smith Mem. Opp'n Intesa Mot. Dismiss 1.

[38] *Smith* SAC ¶¶ 489-501.

[39] *Id.* ¶ 502.

C. Deloitte USA

The third category of allegations involves claims arising from the conduct of Deloitte USA.

1. Auditing Services

Plaintiffs claim that Deloitte USA misled innocent insiders at the Companies by issuing unqualified audit opinions of Parmalat USA's financial statements for the years 1999 to 2002.

a. Reimbursement Credits

They allege that Parmalat USA had booked millions of dollars worth of "reimbursement credits" issued by Parmalat between 1999 and 2002.[40] The credits had been booked as reductions in costs and expenses and therefore increased Parmalat USA's reported net income and assets.[41] Plaintiffs claim, however, that the credits in fact were "uncollectible."[42] They allege that Deloitte USA violated generally accepted auditing standards ("GAAS") by failing to obtain sufficient audit evidence that the credits were genuine despite "red flags" that should have cued it into the fact that they were phony.[43]

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[40] *Pappas* SAC ¶ 83.

[41] *Id.* ¶¶ 77, 85.

[42] *Id.* ¶ 97.

[43] *Id.* ¶¶ 89-94.

In particular, plaintiffs claim that when Deloitte USA conducted a "successor audit" of Parmalat USA in 1999, it discovered that the company had not collected on similar reimbursement credits issued from 1995 to 1998.[44] They allege also that when Deloitte USA "sought confirmation from [Parmalat and Deloitte Italy] of the calculations and nature of the reimbursement credits" and "questioned why the reimbursement credits were accounted for as reimbursement of expenses as opposed to a capital contribution from [Parmalat]," it "did not receive the confirmations and information it requested" because Parmalat and Deloitte Italy "repeatedly refused to provide such audit evidence."[45] Plaintiffs allege further that Carlo Zucchinali of Deloitte Italy sent a January 18, 2000 email to James Pickette, Deloitte USA's audit manager, describing the reimbursement credits as "loss absorptions," or "contributions – income for the receiving company – from other Parmalat companies to cover losses."[46]

According to plaintiffs, Deloitte USA knew or should have known that the reimbursement credits were uncollectible and that Parmalat USA's financial condition was overstated in its financial statements. It therefore acted improperly in failing to qualify its audit opinions.[47]

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[44] *Id.* ¶¶ 76-82.

[45] *Id.* ¶¶ 93-99.

[46] *Id.* ¶ 97.

[47] *Id.* ¶ 99.

b. Going Concern Qualifications

Plaintiffs claim that Deloitte USA failed to issue going concern qualifications in its audit opinions. Because Parmalat USA was financially dependent on Parmalat, they allege, Deloitte USA was required by GAAS either to obtain evidence that Parmalat in fact intended to give, and was capable of giving, continued financial support to Parmalat USA, or to reveal in its audit opinions that there was substantial doubt about the company's ability to continue as a going concern.[48] Plaintiffs claim that Deloitte USA failed to do either.

In connection with its audits of Parmalat USA for the years 1999 to 2001, Deloitte USA allegedly sought only representations from Parmalat's managers that Parmalat would continue to support Parmalat USA. Plaintiffs claim that this was insufficient under GAAS.[49]

On May 8, 2003, in connection with Parmalat USA's 2002 audit, Astrid Potts of Deloitte USA allegedly "sought from [Deloitte Italy] and Parmalat-SpA details of the *actual audit evidence* – not just the representation from Parmalat-SpA's management that had become the norm – that [Deloitte Italy] was relying upon to confirm Parmalat-SpA would not call loans to Parmalat-USA due during 2003 and that Parmalat-SpA had the ability to continue to provide financial support to Parmalat-USA."[50] According to

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[48] *Id.* ¶¶ 100-109.

[49] *Id.* ¶¶ 110-115.

[50] *Id.* ¶ 116 (emphasis in original).

plaintiffs, "Lelio Bigogno of [Deloitte Italy] responded that same day to Potts, refusing to provide the requested audit evidence: 'I do not believe that out consideration on the capability of Finanziaria *to support or on whatsoever information about our* audit procedures should be shared with you [*sic*].'"[51]

Plaintiffs claim that Bigogno's response to Potts should have signaled to Deloitte USA that there was serious doubt about Parmalat's ability and intention to continue supporting the Companies. Nevertheless, plaintiffs allege, Deloitte USA improperly issued an unqualified audit opinion of Parmalat USA's 2002 financial statements.[52]

(c) Overstatement of Goodwill

The complaints allege also that Deloitte USA failed to reveal that Parmalat USA's goodwill was overstated in financial statements.

According to plaintiffs, "[f]or the years 2000 and 2001, the goodwill reported on the balance sheet of Parmalat-USA constituted approximately half or more of Parmalat-USA's total reported assets" and that "[r]eported goodwill and other intangible assets totaled approximately $202 million at the end of fiscal year 2000 and $198 million at the end of fiscal year 2001."[53] Plaintiffs allege that "the results of the underlying

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[51] *Id.* ¶ 117 (emphasis and [*sic*] in original).

[52] *Id.* ¶¶ 118-120.

[53] *Id.* ¶ 129.

operations of Parmalat-USA and its subsidiaries did not justify" the reported values.[54]

When it became clear that the company's goodwill was overstated, Deloitte USA and Parmalat USA reduced reported goodwill by $26.5 million. Plaintiffs contend that "even this write-down was not sufficient."[55] They allege that Deloitte USA knew or should have known that Parmalat USA's goodwill was misstated, and that had it conducted its audits in accordance with GAAS, it would have revealed this in its audit opinions.[56]

2. The Sale-Leaseback Transaction

The remaining allegations against Deloitte USA arise from a 2003 transaction between Farmland and General Electric Capital Corporation ("GECC").

a. The Proposed Deal

The complaints allege that, in late 2002, Parmalat's corrupt insiders "desperately needed increasing amounts of cash in order to fund their fraudulent

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[54] *Id.* ¶ 130.

[55] *Id.* As noted, plaintiffs allege also that "Deloitte" failed to ensure that this write-down "flow[ed] through" to Parmalat's consolidated financial statements. *Id.* ¶ 131. They do not specify to which Deloitte entity they refer in making this allegation. But plaintiffs suggest elsewhere in the pleadings that it was Deloitte Italy that was responsible for ensuring that adjustments to the Companies' financial statements "flowed through" to Parmalat's financial statements. *See id.* ¶ 191.

[56] *Id.* ¶ 132.

scheme." Parmalat hired Citigroup Global Markets ("CGM") to locate an investor to provide financing using Farmland's assets as security.[57] GCM found GECC.

GECC and Parmalat initially contemplated that GECC would lend $200 million to Farmland in the form of a sale-leaseback transaction – Farmland would transfer its dairy processing plants and equipment to GECC in exchange for $200 million in cash and then lease the assets back. It allegedly "was understood that the financing would be upstreamed to Parmalat-SpA and that Parmalat-SpA was the ultimate creditor." Parmalat therefore would guarantee the leases.[58] The transaction later was restructured and divided into two tranches, the first of which was $100 million and the second $94 million.[59]

GECC required that it be provided with Parmalat USA's audited financial statements for the years 2000 and 2001. During the winter of 2002 and the spring of 2003, Deloitte USA provided GECC with the requested documents. Plaintiffs allege that "GECC also received Parmalat-USA's unaudited financial statements for 2002.[60]

GECC required also that Farmland's dairy processing equipment be appraised. This was in part

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[57] *Id.* ¶ 223.

[58] *Id.* ¶ 224.

[59] *Id.* ¶ 240.

[60] *Id.* ¶¶ 225-226.

because GECC required "the outstanding loan amount to be over-collateralized at all times by at least 30% (i.e., 1.3 times)." GECC therefore required Farmland's assets to be worth at least $252.2 million, or 130 percent of $194 million.[61]

b. The Deloitte USA-Deloitte Italy Dispute

Plaintiffs allege that, in September 2002, CGM "requested" that GECC use Deloitte USA as the appraiser of Farmland's assets.[62] When Adolfo Mamoli of Deloitte Italy found out about this, he objected vigorously, claiming that the appraisal assignment necessarily would compromise Deloitte USA's independence with respect to its audits of Parmalat USA. That is, Mamoli complained that if Deloitte USA served both as an appraiser of Farmland's assets and as auditor of Parmalat USA, it ultimately would have to audit a transaction, the value of which would have been based upon its own appraisal. Plaintiffs allege that Mamoli voiced his objection repeatedly between September 5, 2002 and January 16, 2003.[63]

Charles Horstmann, DTT's global director of ethics and independence, "was responsible for mediating disputes between [Deloitte] member firms, including those arising out of the Parmalat account." Horstmann, "on behalf of DTT and at the request of [Deloitte USA]," allegedly intervened in the dispute

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[61] *Id.* ¶¶ 240-241.

[62] *Id.* ¶ 227.

[63] *Id.* ¶¶ 228-229.

between Deloitte USA and Deloitte Italy.[64] Plaintiffs allege that Horstmann was able to "persuade Mamoli to withdraw his objection" "[a]fter a long series of e-mails, telephone conversations, and at least one face-to-face meeting." Mamoli allegedly withdrew his objection "even though the substance of that objection was not resolved."[65]

c. The Appraisal

Sometime in March 2003, "GECC executed a letter agreement with [Deloitte USA] dated February 21, 2003, whereby [Deloitte USA] agreed to appraise" the property that would be subject to the sale-leaseback transaction.[66]

On April 30, 2003, Deloitte USA issued an appraisal report. According to plaintiffs, the report inflated the appraisal value of Farmland's assets. It allegedly reported an appraisal value of $252.5 million – more than enough to meet GECC's collateralization requirements for a $194 million transaction – even though an appraisal performed in 1999 by Daley-Hodkin Appraisal Corporation ("DHAC") valued

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[64] *Id.* ¶¶ 268-269.

[65] *Id.* ¶¶ 230-232.

[66] *Id.* 233. Plaintiffs allege that Deloitte USA then attempted to resolve the independence issue raised by Mamoli by establishing a "Chinese Wall" between the team responsible for appraising Farmland and the team that audited Parmalat USA. According to plaintiffs, however, the wall was "porous," and in any event imposed a scope limitation on Deloitte USA's audit of Parmalat USA in violation of GAAS. *Id.* ¶ 235.

Farmland's assets at about $35 million. Plaintiffs contend that Deloitte USA's appraisal report "provided no explanation or justification for an over seven-fold increase in the value of Farmland's assets in four years, despite Farmland having reported substantial operating losses over the same period."[67]

Plaintiffs allege that the overvaluation stemmed from the fact that Deloitte USA "ignored two of the three basic approaches to valuation[, t]he Cost Approach and the Market Comparable Approach," and instead applied only the "Discounted Cash Flow Approach."[68] Moreover, plaintiffs allege, in applying the discounted cash flow approach, Deloitte USA relied on "calculated" instead of actual values for Farmland's 2001 and 2002 earnings before income taxes, depreciation, and amortization ("EBITDA"). Deloitte USA allegedly stated in its appraisal report that Farmland's EBITDA for 2002 was unavailable, and therefore projected the company's 2003 EBITDA value and then "calculated" EBITDA values for previous years "by reducing the 2003 projections by 2.5% per year." Plaintiffs claim that Deloitte USA did this despite knowing Farmland's actual EBITDA values for 2002. According to plaintiffs, Deloitte USA's "calculated" EBITDA values "far exceeded" the actual values.[69]

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[67] *Id.* ¶¶ 238-243.

[68] *Id.* ¶¶ 244-245.

[69] *Id.* ¶¶ 245-247.

d. The Aftermath

On the same day that Deloitte USA issued its appraisal report, Farmland transferred its dairy processing plants and equipment to GECC for $100 million. It agreed to make periodic lease payments totaling $50 million plus interest and costs and a residual payment of $50 million at the end of the lease term.[70] Although plaintiffs do not so allege, the complaints imply that this $100 million transaction represented only the first tranche of sale-leaseback transaction.

In February 2004, Farmland was unable to make its lease payments. Moreover, as Parmalat already had been declared insolvent in Italy, Parmalat "failed to honor its obligations under its guarantee given to GECC."[71]

Plaintiffs claim that the sale-leaseback transaction would not have gone forward if Farmland's assets had been valued properly. They claim that a proper appraisal would have revealed not only that the transaction was not sufficiently collateralized to meet GECC's requirements, but also that there were substantial doubts about the Companies' abilities to

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[70] *Id.* ¶ 7.

[71] *Id.* ¶ 253.

continue as going concerns.[72] Hence, plaintiffs contend that Farmland would not have incurred a liability on which it ultimately defaulted when Parmalat collapsed if Deloitte USA had acted properly.[73]

The complaints allege also that, after Farmland entered into the sale-leaseback transaction and received the $100 million from GECC, Parmalat's insiders "looted the cash by causing Farmland to ultimately divert $20 million to Parmalat's Canadian operations and $80 million to Parmalat" itself.[74]

III. Causes of Action

Plaintiffs assert causes of action against all defendants for aiding and abetting breach of fiduciary duty[75] and fraud[76] by the Parmalat insiders, as well as for participating in a civil conspiracy to conceal Parmalat's financial condition.[77] They allege also violations by the Bank of America and Deloitte Defendants of the federal and New Jersey Racketeer

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[72] *See id.* ¶¶ 245 (alleging that Deloitte USA overvalued Farmland's assets in order to make sure that GECC's collateralization requirement was met), 248 (proper appraisal would have called into question "the viability of Parmalat-USA and its subsidiaries as going concerns").

[73] *Id.* ¶ 65.

[74] *Id.* ¶ 7.

[75] *Pappas* SAC Count I; *Smith* SAC Count I.

[76] *Pappas* SAC Count II; *Smith* SAC Count III.

[77] *Pappas* SAC Count VI; *Smith* SAC Count VII.

Influenced and Corrupt Organizations Acts ("RICO")[78] based on alleged predicate acts of mail and wire fraud.[79] In connection with the auditing services Deloitte USA provided to the Companies, plaintiffs sue the Deloitte Defendants for fraud,[80] negligent misrepresentation,[81] and professional malpractice.[82] Finally, Smith asserts a claim against the Bank of America, Deloitte, and Grant Thornton Defendants for aiding and abetting a fraudulent transfer of Farmland's assets.[83]

The Deloitte, Bank of America, and Credit Suisse Defendants, as well GTI, GT USA, and BNL move to dismiss the claims against them in both complaints. In addition, Intesa moves to dismiss the claims against it in Smith's complaint.

Discussion

I. Standard

In deciding a motion to dismiss, the Court ordinarily accepts as true all well-pleaded factual allegations and draws all reasonable inferences in the

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[78] 18 U.S.C. § 1961 *et seq.*; N.J.S. 2c:41-1 *et seq.*

[79] *Pappas* SAC Count VII; *Smith* SAC Count VIII.

[80] *Pappas* SAC Count III; *Smith* SAC Count IV.

[81] *Pappas* SAC Count IV; *Smith* SAC Count V.

[82] *Pappas* SAC Count V; *Smith* SAC Count VI.

[83] *Smith* SAC Count II.

The Court has jurisdiction pursuant to 28 U.S.C. § 1334.

plaintiff's favor.[84] Until recently, it frequently was said that dismissal is inappropriate "unless it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief"[85] This standard, however, has been supplanted. Now, in order "[t]o survive dismissal, the plaintiff must provide the grounds upon which his claim rests through factual allegations sufficient 'to raise a right to relief above the speculative level.'"[86]

In addition, Federal Rule of Civil Procedure 9(b) requires allegations of fraud and breach of fiduciary duty consisting of fraud by a fiduciary to be stated with particularity.[87] While the rule allows general averments of intent, knowledge, and other mental conditions, it nevertheless requires a plaintiff to allege facts that give rise to a "strong inference" of the defendant's culpable state of mind.[88] This may be done

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[84] *Levy v. Southbrook Int'l Invs., Ltd.*, 263 F.3d 10, 14 (2d Cir. 2001), *cert. denied*, 535 U.S. 1054 (2002)).

[85] *Cohen v. Koenig*, 25 F.3d 1168, 1172 (2d Cir. 1994) (quoting *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957)).

[86] *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, __ F.3d __, 05-5132-cv, 2007 WL 1989336, *5 (2d Cir. Jul. 11, 2007) (quoting *Bell Atl. Corp. v. Twombly*, 127 S.Ct. 1955, 1965 (2007)); *see also Iqbal v. Hasty*, __ F.3d __, 05-5768-CV(L), 2007 WL 1717803, *11 (2d Cir. 2007) (discussing breadth of *Bell Atl.* holding and declining to limit it solely to the antitrust context).

[87] FED. R. CIV. P. 9(b); *Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt. LLC.*, 479 F. Supp. 2d 349, 359-60 (S.D.N.Y. 2007).

[88] *See, e.g., Fraternity Fund*, 479 F. Supp. 2d at 360, 367; *see also Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S.Ct. 2499, 2510 (2007) (plaintiff must allege facts that give rise to "strong

by alleging facts that the defendant had both motive and opportunity to commit or assist fraud, or facts that constitute strong circumstantial evidence of the defendant's conscious misbehavior or recklessness.[89]

II. Choice of Law

Plaintiffs argue that New Jersey law applies to all of their claims. Some defendants resist this; others do not. However, the parties point to no conflict between the law of the forum and that of any other state with respect to the issues necessary to dispose of these motions. Accordingly, the Court applies New York law.[90]

III. Injury

The complaints allege two kinds of injury to the Companies. First, plaintiffs contend that defendants' improper actions misled innocent decision makers at the Companies about Parmalat's financial health.

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inference" of fraudulent intent, which means inference "must be cogent and compelling, thus strong in light of other explanations").

[89] *E.g., Fraternity Fund Ltd. v. Beacon Hill Asset Mgmt.* LLC, 376 F. Supp. 2d 385, 404 (S.D.N.Y. 2005) (quoting *Acito v. IMCERA Group*, 47 F.3d 47, 52 (2d Cir. 1995) (quoting *Shields v. Citytrust Bancorp, Inc.*, 25 F.3d 1124, 1128 (2d Cir. 1994))).

[90] *See, e.g., Antaeus Enters., Inc. v. SD-Barn Real Estate, L.L.C,* 480 F. Supp. 2d 734, 740 (S.D.N.Y. 2007) (law of forum applies if no conflict is shown to exist (citing *Faulkner v. Nat'l Geographic Soc.*, 452 F. Supp. 2d 369, 375 n.25 (S.D.N.Y. 2006); *Carroll v. LeBoeuf, Lamb, Greene & MacRae, L.L.P.*, 392 F. Supp. 2d 621, 625 n.21 (S.D.N.Y. 2005))); *In re Parmalat Sec. Litig.*, 479 F. Supp. 2d 332, 342 n.56 (S.D.N.Y. 2007).

Believing, incorrectly, that Parmalat could provide the Companies with continuing financial support and guarantee its loans, the innocent decision makers caused the already-insolvent Companies to incur debt they were unable to pay, thus deepening their insolvency. Second, plaintiffs claim that the $100 million GECC paid to Farmland as part of the sale-leaseback transaction was looted by Parmalat's corrupt insiders.

A. Deepened Insolvency

The parties devote a great deal of space to arguing whether courts recognize "deepened insolvency" damages or "deepening insolvency" causes of action. But this ultimately is beside the point, as plaintiffs have failed adequately to allege that the Companies were injured when they allegedly were induced to incur debt, whatever the claimed injury should be labeled.

1. Debt and Insolvency

Plaintiffs assume that the mere act of incurring debt when a company already is insolvent – that is, when its liabilities are greater than the value of its

assets[91] or when it is unable to repay its existing debt[92] – necessarily deepens the company's insolvency. This is not the case.

When, for example, a company borrows cash and receives the full amount of the loan, it receives an asset that directly offsets the newly incurred liability on its balance sheet. In other words, the company "expand[s] debt in *precise* proportion – dollar-for-dollar proportion – to the expansion of assets in the form of new cash.[93] The difference between the company's assets and liabilities therefore remains the same. Its ability to pay its debts as they become due is no worse;

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[91] *See* 11 U.S.C. § 101(32)(A) (a corporation is insolvent when "the sum of [the] entity's debts is greater than all of [the] entity's property, at a fair valuation"); Sabin Willett, *The Shallows of Deepening Insolvency*, 60 BUS. LAW. 549, 552 (2005) [hereinafter, "*Shallows*"] (describing "balance sheet insolvency" as the condition where liabilities are greater than the value of assets).

[92] *See, e.g.*, OXFORD ENGLISH DICTIONARY, "Insolvent" ("Unable to pay one's debts or discharge one's liabilities; bankrupt.") (*available at* http://dictionary.oed.comicgi/entry/50118117?single=1&query_type=word&queryword=insolvent&first---1&max_to_show---10) (last visited July 31, 2007); *see also* BLACK'S LAW DICTIONARY (8th ed. 2004), "Insolvent" ("having liabilities that exceed the value of assets; having stopped paying debts in the ordinary course of business or being unable to pay them as they fall due"); *Shallows*, 60 BUS. LAW. at 552 (describing "cash-flow insolvency" – "where a company intends or believes that it will incur debts that would be beyond its ability to pay as those debts mature" – and "low capital insolvency" – "where a company engages in a business or transaction that its capital is simply too small to protect against the risk of future setbacks").

[93] *Shallows*, 60 BUS. LAW. at 555.

indeed, it may be better. The company's insolvency is no greater than before.[94]

The Ninth Circuit recognized this in *Rochelle v. Marine Midland Grace Trust Co. of New York.*[95] Rochelle, the trustee of a bankrupt company, Sunset, sued directors, officers, and auditors for mismanaging, looting, and otherwise breaching duties owed to the company. He asserted claims under the federal securities laws, arguing that Sunset was injured when the defendants misrepresented the company's financial health in order to secure loans that the company actually was unable to pay, thus deepening Sunset's insolvency. The court noted, however, that because Sunset received the full amount of the loans, it suffered no loss on the loan transactions in question. The court thus observed that Rochelle's theory was that Sunset's injury was caused not by the incurrence of debt, but rather by management's subsequent squandering of the loan proceeds. This, the court concluded, amounted to a claim of corporate mismanagement, and was not actionable under the securities laws.[96]

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[94] From the point of view of creditors, the company's insolvency in some circumstances may become *shallower* as a result of its incurrence of new debt. *See Shallows*, 60 BUS. LAW. at 552-53.

[95] 535 F.2d 523 (9th Cir. 1976).

[96] *See id.* at 528-29; *see also In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 539 (S.D.N.Y. 1980) ("Since [company] received more than fair value in exchange for its debentures and other securities, it was not damaged until the proceeds from such sales were subsequently misused.")

The point is that a company's insolvency is not deepened simply by the incurrence of new debt where the company suffers no loss on the loan transaction.[97] The insolvency is deepened when, for example, the proceeds of the loan are squandered or assets otherwise are looted.[98] It is at that point that the gap between liabilities and assets widens and the ability to service outstanding debt is impaired.

The Companies are not alleged to have suffered any loss on the loan transactions in question. Accordingly, it would be misleading to refer to any injury the Companies may have suffered by incurring debt as "deepened insolvency." This is not to say, however,

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[97] *See Rubin v. Mfrs. Hanover Trust Co.*, 661 F.2d 979, 991 (2d Cir. 1981) (construing statute limiting when bankruptcy trustee can set aside obligation incurred by debtor and concluding that "if the debtor receives property or discharges or secures an antecedent debt that is substantially equivalent in value to the property given or obligation incurred by him in exchange, then the transaction has not significantly affected his estate and his creditors have no cause to complain"); *cf. In re CitX Corp., Inc.*, 448 F.3d 672, 677 (3d Cir. 2006) (use of fraudulent financial statements to raise $1 million in capital from investors did not deepen insolvency, but in fact made it shallower).

[98] *See Investors Funding Corp.*, 523 F. Supp. at 539; *see also In re Global Serv. Group, LLC*, 316 B.R. 451, 461 (S.D.N.Y. Bankr. 2004) (allegations that management prolonged the life of an insolvent corporation that continues to incur debt, without more – such as an allegation that management subsequently misappropriated the funds received – does not state a claim for relief); *see also CitX*, 448 F.3d at 677 (increase in insolvency does not occur when there is a capital infusion, but when the cash subsequently is looted or squandered).

that the Companies necessarily suffered no injury at all.[99]

2. Debt and Injury

In *Official Committee of Unsecured Creditors v. R.F. Lafferty & Co., Inc.*,[100] the successors of two bankrupt corporations alleged that the corporations had been induced fraudulently to incur debt that they were unable to pay, thereby forcing them into bankruptcy. Although the Third Circuit framed the issue as whether Pennsylvania recognizes a cause of action for "deepening insolvency,"[101] it addressed the underlying question – whether the corporations could have suffered any injury as a result of the alleged fraud. The court wrote:

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[99] *Cf. In re Parmalat Sec. Litig.*, 383 F. Supp. 2d 587, 601-02 (S.D.N.Y. 2005) (declining to recognize deepening insolvency cause of action under North Carolina law where injuries plaintiff complained of were equally compensable under more traditional tort theories, such as breach of fiduciary duty).

[100] 267 F.3d 340 (3d Cir. 2001).

[101] As the court stated in a subsequent case,

> "[a]lthough [in *Lafferty*] we did describe deepening insolvency as a 'type of injury,' and a 'theory of injury,' we never held that it was a valid theory of damages for an independent cause of action. Those statements in *Lafferty* were in the context of a deepening-insolvency *cause of action*. They should not be interpreted to create a novel theory of damages for an independent cause of action like malpractice." *CitX*, 448 F.3d at 677 (citations omitted; emphasis in original).

"Even when a corporation is insolvent, its corporate property may have value. The fraudulent and concealed incurrence of debt can damage that value in several ways. For example, to the extent that bankruptcy is not already a certainty, the incurrence of debt can force an insolvent corporation into bankruptcy, thus inflicting legal and administrative costs on the corporation. When brought on by unwieldy debt, bankruptcy also creates operational limitations which hurt a corporation's ability to run its business in a profitable manner. Aside from causing actual bankruptcy, deepening insolvency can undermine a corporation's relationships with its customers, suppliers, and employees. The very threat of bankruptcy, brought about through fraudulent debt, can shake the confidence of parties dealing with the corporation, calling into question its ability to perform, thereby damaging the corporation's assets, the value of which often depends on the performance of other parties. In addition, prolonging an insolvent corporation's life through bad debt may simply cause the dissipation of corporate assets.

"These harms can be averted, and the value within an insolvent corporation salvaged, if the corporation is dissolved in a timely manner, rather than kept afloat with spurious debt."[102]

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[102] *Lafferty*, 267 F.3d at 349-50 (citations omitted); *see generally* J.B. Heaton, *Deepening Insolvency*, 30 J. Corp. L. 465 (Spring 2005) (wrongfully incurred debt may cause a company injury in the form of "costs of financial distress" – such as the administrative costs of bankruptcy, or a decline in assets and

Plaintiffs do not claim that defendants' actions ultimately drove the Companies into bankruptcy. Indeed, they allege that the Companies already were insolvent by 1999 and would have filed for bankruptcy even sooner than they did had Parmalat's true financial condition been revealed. Nor do plaintiffs allege that the Companies' incurrence of new debt harmed their business relationships, reputations, or otherwise hindered their operations. The complaints instead appear to draw on *Lafferty*'s final theory of damages – that "prolonging [the Companies'] life through bad debt . . . cause[d] the dissipation of corporate assets."[103]

Plaintiffs allege that innocent decision makers at the Companies would have sought "an orderly reorganization or liquidation of [the Companies] at a much earlier date, thus preserving assets,"[104] had Parmalat's insolvency been revealed. In other words, plaintiffs claim that the Companies were injured in that they were induced to delay filing for bankruptcy.

a. Delayed Liquidation

Although plaintiffs assume that delayed liquidation and delayed reorganization would have injured the Companies equally, there is a critical difference. If the Companies were insolvent by 1999 and liquidation was

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profits as a result of damaged reputation – but company is not harmed by amount of wrongfully incurred debt). *But see Shallows*, 60 Bus. Law at 564-67 (critiquing *Lafferty*'s reasoning).

[103] *Id.* at 350.

[104] *Pappas* SAC ¶ 159.

inevitable, then they had nothing to lose simply by continuing to operate, even if that would have meant the continued depletion of their assets. As one commentator writes,

> "In a liquidation, assets will be sold and the proceeds distributed to creditors. [In cases where] liquidation is inevitable . . . [the harm caused by delayed bankruptcy filing is a] harm to the beneficiaries of that liquidation – the creditors. The corporation is no more one of them than the deceased is a beneficiary at the reading of his own will. If asset liquidation is the inevitable best case, the corporation is defunct. Delay does not hinder its ability to purchase raw material, operate its factories, sell widgets, collect receivables, make payroll, or sponsor the Mite A hockey team. All of those attributes of corporate life are gone, and once again we are adding insult only to death."[105]

Accordingly, insofar as plaintiffs claim that the Companies were induced to delay in liquidating, they have failed to allege harm to the Companies themselves. And they of course lack standing to recoup damages suffered by others, such as the Companies' creditors.[106]

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[105] *Shallows*, 60 BUS. LAW. at 566.

[106] *E.g.*, *In re Parmalat Sec. Litig.*, 383 F. Supp. 2d 587, 594 (S.D.N.Y. 2005) (citing cases).

b. Delayed Reorganization

However, insofar as plaintiffs claim that the Companies were injured because they were induced to delay filing for reorganization, the conclusion may be different.

(1) Parmalat USA

Parmalat USA currently is in liquidation. If, however, Parmalat USA, at some point prior to February 2004, might have filed for reorganization and continued operating under bankruptcy protection instead of simply liquidating, it arguably missed the opportunity to fight for survival under bankruptcy protection. Its successor in interest then might have a case if he could establish that defendants' actions caused the company to miss that opportunity.

The complaints allege few facts concerning Parmalat USA's financial condition prior to February 2004. They allege that Parmalat USA's financial statements for the years 2000 to 2002 reported that the company's insolvency – the amount by which liabilities exceeded assets – increased from about $40 million to about $47.5 million.[107] This hardly establishes, however, that reorganization and continued operation would have been a viable option had the company filed for bankruptcy sooner than it did. The allegations, if proven, would leave a fact finder to speculate not only as to whether Parmalat

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[107] *Pappas* SAC ¶ 103.

USA would have filed for bankruptcy sooner,[108] but also as to whether the trustees would have sought reorganization as opposed to liquidation, and whether a plan for reorganization would have been approved. This is too much. Plaintiffs have not supplied factual allegations sufficient to raise a right to relief above the speculative level.

(2) Farmland

Farmland is in a slightly different boat, as it filed for reorganization, and a plan was approved. It therefore was not deprived of the opportunity to fight for survival under bankruptcy protection. Nevertheless, it perhaps could be argued that Farmland was injured because it emerged from bankruptcy with a lower enterprise value than it otherwise would have as result of being induced to delay reorganization.

The viability of this theory is not free from doubt.[109] Regardless, plaintiffs do not allege that Farmland operated at a loss or that its assets diminished in value simply as a result of the company's continued

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[108] Simply because a company is insolvent does not mean it necessarily will file for bankruptcy. *Global Serv. Group*, 316 B.R. at 460 (unlike some jurisdictions, American law does not require company's management to file for bankruptcy, but leaves the decision up to proper business judgment).

[109] *See Shallows*, 60 BUS. LAW. at 567-68 (discussing theory and potential problems).

operations.[110] The allegations therefore do not support the conclusion that earlier rather than later bankruptcy would have stemmed any additional losses or left the company with more assets.

Even if plaintiffs had alleged that Farmland's assets were depleted merely by continued operations, the allegations still would fail. It is too speculative to conclude that an earlier reorganization would have left Farmland, as opposed to some other interested party, better off. Bankruptcy reorganization is an inherently flexible process, as a bankruptcy court has broad equitable powers to craft a reorganization plan. In exercising those powers, a court must consider the interests of a number of relevant parties, including not

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[110] Plaintiffs do allege that Farmland's assets were depleted when they were up-streamed to Parmalat and subsequently looted. Allegations that the Companies were injured by corporate looting are dealt with more fully below. The present question, however, is not whether earlier bankruptcy would have prevented intervening factors, such as the Parmalat fraud, from affecting Farmland. Rather, it is whether the mere continuation of Farmland's operations outside of bankruptcy left the company worse off – that is, whether the mere incurrence of debt, separate and apart from what happened to the loan proceeds, caused injury to the company.

As noted, plaintiffs allege that the consolidated financial statements of "Parmalat USA and its subsidiaries" revealed that Parmalat USA's insolvency increased by about $7.5 million between 2000 and 2002, *Pappas* SAC ¶ 103, during which period Parmalat USA incurred more debt, *id.* ¶ 151. This may suggest that Parmalat USA's assets were losing value. The reference to "Parmalat USA and its subsidiaries" however is quite vague and does not specify Farmland in particular. The allegations therefore do not indicate whether the assets of Farmland itself were losing value.

only the debtor, but also its creditors.[111] Given this flexibility – and the paucity of allegations concerning Farmland's financial condition before February 2004 – it is difficult, perhaps impossible, to say what a hypothetical reorganization plan might have looked like had Farmland filed for bankruptcy protection at some unspecified earlier date. Even assuming that Farmland's estate would have been more valuable if bankruptcy protection had been sought earlier, it is far from clear that any of this additional value necessarily or probably would have been left to Farmland, as opposed to distributed to its creditors or other interested parties. Hence, too much speculation is required to conclude that Farmland itself would have benefitted from earlier bankruptcy protection. Accordingly, even if the complaints contained allegations supporting this theory of injury, they would not raise plaintiffs' right to relief beyond the speculative level.

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In sum, while the incurrence of debt by itself cannot deepen a company's insolvency, the Court is not prepared to conclude that it never can cause injury to an insolvent company. But plaintiffs nevertheless have failed to allege that it caused injury to the Companies

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[111] *See, e.g., Pioneer Inv. Servs. Co. v. Brunswick Assocs. Ltd. P'ship*, 507 U.S. 380, 389 (1993) ("In overseeing [the Chapter 11 reorganization] process, the bankruptcy courts are necessarily entrusted with broad equitable powers to balance the interests of the affected parties, guided by the overriding goal of ensuring the success of the reorganization."); *N.L.R.B. v. Bildisco*, 465 U.S. 513, 525 (1984) (noting that flexibility and equity are "built into" Chapter 11).

in this case. Accordingly, plaintiffs' claims must be dismissed insofar as they seek damages for the Companies' wrongful incurrence of debt.

B. Looting

This does not dispose of all of plaintiffs' claims, however. The complaints allege that Farmland acquired $100 million as part of the sale-leaseback transaction, and that this money subsequently was looted when Parmalat insiders diverted the funds to other Parmalat entities. As the foregoing analysis indicates, the looting of the proceeds of a loan can constitute an injury to a company.[112] Even assuming the truth of plaintiffs' allegations, however, the question whether the complaints adequately allege that defendants' actions caused the Companies' injuries would remain.

IV. Causation

Plaintiffs cannot succeed on any of their claims unless they establish that defendants' conduct caused the Companies' losses. It is not sufficient that they show "but for" causation. They must prove also that

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[112] As indicated above, *this* deepens a corporation's insolvency, as it leaves the corporation not only with a new liability but also fewer assets. It therefore might be appropriate to identify the injury caused by the looting of loan proceeds as "deepened insolvency." But the Court sees little reason to do so. The traditional name – looted assets – is sufficient.

defendants' actions were the proximate cause of the Companies losses.[113]

A. Defendants Other Than Deloitte USA

In *Bloor v. Carro, Spanbock, Londin, Rodman & Fass,*[114] the trustee of a bankrupt company alleged a massive scheme in which the company's officers and controlling stockholders mismanaged the firm and looted corporate funds. The trustee sued, among others, a law firm in connection with its preparation of the company's SEC filings and other documents, which allegedly misrepresented the company's financial condition. The trustee claimed that these misrepresentations allowed the company to raise large amounts of capital, which ultimately was looted as part of the ongoing fraud at the company. The Second Circuit held, however, that this was insufficient to plead loss causation under the securities laws, as it amounted merely to a claim of "but for" causation. The

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[113] *See, e.g., Fraternity Fund,* 479 F. Supp. 2d at 370-71 (aiding and abetting fraud and breach of fiduciary duty); *First Capital Asset Mgmt., Inc. v. Brickellbush, Inc.,* 218 F. Supp. 2d 369, 379 (S.D.N.Y. 2002) (federal RICO); *Duane Jones Co. v. Burke,* 306 N.Y. 172, 190-91, 117 N.E.2d 237, 246 (1954) (civil conspiracy); *Kristina Denise Enters., Inc. v. Arnold,* 41 A.D.3d 788, 838 N.Y.S.2d 667, 667 (2d Dep't 2007) (accounting malpractice); *Gerber Trade Finance, Inc. v. Skwiersky, Alpert & Bressler, LLP,* 12 A.D.3d 286, 286, 786 N.Y.S.2d 9, 10 (1st Dep't 2004) (negligent misrepresentation); *Laub v. Faessel,* 297 A.D.2d 28, 30-31, 745 N.Y.S.2d 534, 536 (1st Dep't 2002) (fraud, negligent misrepresentation, and breach of fiduciary duty (citing cases)); *Interchange State Bank v. Veglia,* 286 N.J. Super. 164, 178, 668 A.2d 465, 472 (N.J. Super. App. Div. 1995) (New Jersey RICO).

[114] 754 F.2d 57 (2d Cir. 1985).

company's alleged losses, the court held, were caused by theft or mismanagement of corporate funds, not the raising of the funds that occurred with the defendant's help.[115]

Plaintiffs allege that Parmalat's true financial condition would have been revealed had defendants acted properly and that either the innocent decision makers at the Companies or GECC would not have allowed the sale-leaseback transaction to go forward. They do not allege, however, that any of the defendants, with the exception of Deloitte USA, had any connection to the Companies or even knew about, assisted, or otherwise participated in the sale-leaseback transaction, let alone the looting of the

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[115] *Id.* at 61-62 ("Any damage sustained by LFC, the only cognizable plaintiff here, occurred later, after the securities transactions were completed, when the proceeds of those transactions were allegedly funneled into unwise investments or diverted to the personal use of the Danskers. . . . [T]he failure of the corporation to use proceeds wisely or the theft of corporate funds by officers was hardly a reasonably foreseeable result, let alone the direct result, of any of Carro Spanbock's alleged actions.").

Although *Bloor* involved securities fraud claims and thus invoked the concepts of "transaction causation" and "loss causation," *see id.* at 61, the decision hinged on the plaintiff's inability to show loss causation, *see id.* at 61-62, which the Second Circuit has held embodies the traditional notion of proximate cause, *see AUSA Life Ins. Co. v. Ernst and Young*, 206 F.3d 202, 209 (2d Cir. 2000) ("Loss causation is causation in the traditional 'proximate cause' sense – the allegedly unlawful conduct caused the economic harm." (citing *Schlick v. Penn-Dixie Cement Corp.*, 507 F.2d 374, 380 (2d Cir. 1974)); *accord Laub*, 297 A.D.2d at 31, 745 N.Y.S.2d at 536 ("Loss causation is the fundamental core of the common-law concept of proximate cause." (citing authority)).

proceeds. Absent such allegations, the Court fails to see how the Companies' losses were a foreseeable result of these defendants' alleged schemes to hide Parmalat's financial condition. As in *Bloor,* plaintiffs perhaps allege that "but for" defendants' actions, the Companies would not have acquired the money that ultimately was looted. But they fail to allege that these defendants could have foreseen not only that the sale-leaseback transaction would have taken place, but also that the proceeds would have been squandered.

Plaintiffs cite the Court's decision in a related case brought by Dr. Enrico Bondi, the Italian representative of Parmalat's bankrupt estate.[116] Dr. Bondi, like plaintiffs here, sued the Bank of America Defendants and others for structuring fraudulent transactions that concealed Parmalat's mounting losses. The Court held that Dr. Bondi adequately pleaded proximate cause where he alleged that the defendants' "material omissions lulled Parmalat's innocent insiders into a false sense of security in the health of the Company" and that "the innocent insiders relied on the mirage" in failing to investigate further and thus failing to discover and halt the fraud.[117]

Dr. Bondi's case, however, involved a substantially shorter chain of causation than plaintiffs allege here. It is reasonably foreseeable that misrepresenting a company's financial condition, and thus hiding from its innocent managers that the company is being driven

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[116] *Parmalat,* 412 F. Supp. 2d 392.

[117] *Id.* at 403-04.

into the ground, will cause the company harm. But it is significantly less foreseeable that doing so will cause a subsidiary with which the defendant has no contact to enter into a transaction of which the defendant has no knowledge and that the subsidiary subsequently will be injured when the proceeds are upstreamed to the parent and looted by its corrupt insiders. In other words, even assuming plaintiffs adequately have alleged that defendants helped perpetuate the Parmalat fraud, they have not alleged that it was foreseeable that the assets of one of Parmalat's subsidiaries would get swept into that scheme and looted and that the Companies thus would be injured.

Accordingly, plaintiffs have failed to plead proximate cause as to defendants other than Deloitte USA.

B. Deloitte USA

Deloitte USA is in a unique position because it audited the Companies and appraised Farmland's assets for purposes of the sale-leaseback transaction. The question, however, is whether these connections made it reasonably foreseeable to Deloitte USA that causing Farmland to enter into the sale-leaseback transaction would result in the looting of the proceeds.

The district court in the *Bloor* case held that neither auditors who overstated the victim company's financial condition in audit reports nor appraisers who overvalued its assets were liable when the money raised as a result of these misrepresentations eventually was looted by the company's management. "While it was arguably foreseeable that, as a result of [the defendants' actions], securities issued and sold by

[the company] would command a higher price than their true value, thus injuring purchasers and providing excessive funds to the corporation, it was not reasonably foreseeable that inside management of [the company] would embezzle the funds so received for their personal use."[118]

Plaintiffs argue that this case is different because Deloitte USA knew that the proceeds of the sale-leaseback transaction would be upstreamed to Parmalat and that Parmalat was being looted by corrupt insiders. It therefore could have foreseen that if Farmland entered into the sale-leaseback transaction, the proceeds would be swept up into the Parmalat fraud. The question thus becomes whether plaintiffs adequately have alleged Deloitte USA's knowledge of the Parmalat fraud.

1. Direct Knowledge

To the extent that plaintiffs rely on allegations that Deloitte USA in fact knew that the proceeds would move upstream to Parmalat and that the corrupt insiders were looting that entity, Rule 9(b) applies, as they allege in substance Deloitte USA's culpable participation in the insiders' fraud.[119]

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[118] *See In re Investors Funding Corp. of New York Sec. Litig.*, 566 F. Supp. 193 (S.D.N.Y. 1983) (appraisers) (citing *In re Investors Funding Corp. of New York Sec. Litig.*, 523 F. Supp. 533, 540 (S.D.N.Y. 1980) (auditors)), *aff'd sub nom., Bloor*, 754 F.2d 57.

[119] *Cf. First Nationwide Bank v. Gelt Funding Corp.*, 27 F.3d 763, 770-772 (2d Cir. 1994) (requiring party to allege loss causation with particularity where claims were premised on fraud).

As noted, Rule 9(b) requires a plaintiff to allege facts raising a strong inference of the defendant's knowledge. The inference may arise where the complaint sufficiently alleges that the defendant (1) benefitted in a concrete and personal way from the purported fraud, (2) engaged in deliberately illegal behavior, (3) knew facts or had access to information suggesting that fraud was being committed, or (4) failed to check information it had a duty to monitor.[120]

The complaints contain no allegations that Deloitte USA stood to receive any benefit from the Parmalat fraud. Rather, they allege that Deloitte USA engaged in deliberately fraudulent behavior by overstating Farmland's assets in its appraisal report, and that it improperly failed to investigate numerous "red flags" indicating that something was amiss at Parmalat. In other words, plaintiffs do not claim that Deloitte USA had motive and opportunity to perpetuate the Parmalat fraud, but that it consciously or recklessly misbehaved.

a. Fraudulent Appraisal

Plaintiffs argue that Deloitte USA's fraudulent intent can be inferred from the fact that it ignored certain valuation methods and relied on projected instead of actual earnings to arrive at an appraisal value of Farmland's assets that inexplicably was seven times greater than the value reported by DHAC four years earlier. They contend also that the inference is strengthened by the fact that Deloitte USA improperly

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[120] *See Fraternity Fund*, 376 F. Supp. 2d at 404 (quoting *Novak v. Kasaks*, 216 F.3d 300, 311 (2d Cir. 2000)).

served as both Parmalat USA's auditor and the appraiser for the sale-leaseback transaction. The argument has superficial appeal. But greater scrutiny reveals that it is not as strong as it appears at first blush.

(1) DHAC's 1999 Appraisal

First, it simply is not the case that Deloitte USA failed to explain why it reported a higher value than DHAC. Unlike DHAC's appraisal, which considered only Farmland's property in Wallington, New Jersey,[121] Deloitte USA's appraisal considered this property as well as property in Atlanta, Brooklyn, Grand Rapids, and Decatur, Alabama.[122] In addition, Deloitte USA's appraisal report explained that there had been a "major investment" in the Wallington facility in "the past few years" and that other equipment had been installed there "recently."[123]

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[121] *See* Toscano Decl. Ex. C [hereinafter, "DHAC Appraisal Report"] at 1, 4-5, 18-22.

[122] *See id.* Ex. B [hereinafter, "Deloitte USA Appraisal Report"] at 13-18, cover letter.

[123] *Id.* at 14.
Plaintiffs relied on both the DHAC and Deloitte USA appraisal reports in making their allegations. *See, e.g., Pappas* SAC ¶ 243. The Court therefore may consider these documents at the pleadings stage. *E.g., Chambers v. Time Warner, Inc.*, 282 F.3d 147, 152-53 (2d Cir. 2002). It may do so, however, only to conclude that certain statements were made therein, not to assess the truth of the matters asserted. *E.g., Loveman v. Lauder*, 484 F. Supp. 2d 259, 268 n.48 (S.D.N.Y. 2007).

This of course does not establish, nor may the Court conclude on a motion to dismiss, that Deloitte USA provided accurate appraisal values in its report. But it substantially undercuts any inference of Deloitte USA's fraudulent intent based on the fact that its appraisal values were higher than DHAC's.

(2) Valuation Approaches

Second, contrary to plaintiffs' allegations, Deloitte USA's appraisal report did not "ignore" the cost and market comparable approaches to valuation.[124] Rather, it considered these approaches, but concluded that the discounted cash flow approach was the most appropriate for valuing Farmland's assets.[125] It stated in the report that the cost approach was not viable because there was a dearth of information "regarding

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[124] According to Deloitte USA's appraisal report, the cost approach "considers the value of facilities in terms of the investment in current labor and materials required to assemble facilities possessing comparable utility to the facilities subject to the appraisal." The market comparable approach "is based upon the observation of actual market transactions between buyers and sellers to establish a value . . . through the identification of market transactions involving similar assets." The discounted cash flow approach "measures the present worth of the expected future economic benefits in the form of cash flows associated with asset ownership." Deloitte USA Appraisal Report 21-22.

To put it more colloquially, the cost approach establishes how much it would cost to replace a piece of property, the market comparable approach establishes how much a potential purchaser would pay for the property, and the discounted cash flow approach establishes the present value of future income expected to be generated by the property.

[125] *Id.* at 25-42.

the composition of the components" of Farmland's property.[126] Moreover, it stated that the market comparable approach was disadvantageous because comparisons to similar properties – the backbone of that approach – necessarily are imperfect. Deloitte USA nevertheless provided a valuation based on the market comparable approach and indicated that it "considered the indication of value from this approach in assessing the reasonableness of the indication of value from [its] primary approach, the discounted cash flow approach."[127]

Plaintiffs do not explain why this was improper. Indeed, DHAC's appraisal report – which plaintiffs assume was accurate – also considered various approaches before concluding that one approach was appropriate for valuing certain properties while other approaches were more useful for valuing other properties.[128] Plaintiffs fail also to explain how or why using other valuation methods besides the discounted cash flow approach would have produced better or more accurate appraisal values. Accordingly, allegations that Deloitte USA ignored certain valuation methods do not raise a strong inference of fraudulent intent.

(3) "Calculated" EBITDA Values

Third, the allegations that Deloitte USA improperly used "calculated" EBITDA values for the years 2001

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[126] *Id.* at 25.

[127] *Id.* at 31

[128] *See* DHAC Appraisal Report 54-55.

and 2002 in employing the discounted cash flow approach are belied by Deloitte USA's appraisal report.

According to the report, Deloitte USA projected 2003 EBITDA values and then reduced them by 2.5 percent per year to arrive at 2001 and 2002 values in employing the market comparable approach, not the discounted cash flow approach. The report states that this was done in order to make Farmland's EBITDA values consistent with those of "guideline companies" to which Farmland was compared for purposes of the market comparable approach, and for which actual 2002 EBITDA values were unavailable.[129] But as noted, Deloitte USA stated in the appraisal report that the market comparable approach was not as appropriate for valuing Farmland's assets as the discounted cash flow approach. In employing the discounted cash flow approach, the report stated, Deloitte USA used historical revenue and other information for 2001 and 2002. It did not "calculate" EBITDA values the way it did for purposes of the market comparable approach. In fact, the report does not state that Deloitte USA considered EBITDA values, "calculated" or otherwise, in applying the discounted cash flow approach.[130]

In light of this, the complaints must be interpreted as alleging that Deloitte USA's statements about the data it used for purposes of employing the discounted cash flow approach were false. But the complaints

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[129] Deloitte USA Appraisal Report 30.

[130] *Id.* at 31-41.

allege no facts raising an inference, let alone a strong inference, that this was the case. A bald allegation that Deloitte USA said one thing and did another is too conclusory to satisfy Rule 9(b).

(4) Failure to Maintain Independence

Finally, an auditor's violation of an ethical duty of independence by itself does not give rise to a strong inference of fraud. It may bolster other facts that tend to demonstrate fraud.[131] Generally, however, an auditor's decision to take on non-audit work that threatens to compromise its duty of independence gives rise to a strong inference of culpable intent only when it is shown that the auditor had a "direct stake" in the alleged fraud.[132]

Plaintiffs do not allege that Deloitte USA stood to benefit from aiding the Parmalat fraud or that it had

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[131] *See, e.g., In re Stone & Webster, Inc., Sec. Litig.*, 414 F.3d 187, 215 (1st Cir. 2005) (Leval, J., sitting by designation) (allegations that auditor had motivation to overlook client's concealment of losses in order to maintain lucrative accounting business may bolster inference of *scienter*, but not enough by itself to give rise to strong inference).

[132] *See In re Royal Ahold N.V. Sec. & ERISA Litig.*, 351 F. Supp. 2d 334, 390-91 (D. Md. 2004) (citing *In re MicroStrategy Inc. Sec. Litig.*, 115 F. Supp. 2d 620, 635-637 (E.D. Va. 2000) (strong inference of fraudulent intent raised where auditor had direct stake in maintaining false appearance of client company's financial health because it agreed to sell company products governed by contract that required long-term commitment from the company, and therefore made it less likely that purchasers would enter into contracts unless there was "clear assurance of the Company's financial health")).

anything to gain from appraising Farmland's assets other than ordinary appraisal fees. The mere expectation of ordinary fees is not a sufficient motive to raise a strong inference of culpable intent.[133]

Moreover, it is of more than passing interest that it was CGM – an entity that is not alleged to have had anything to do with the Parmalat fraud – that "requested" that Deloitte USA conduct the appraisal for GECC. Had Parmalat or some other allegedly culpable entity done so, this perhaps would have taken plaintiffs closer to raising the inference that Deloitte USA's supposed violation of its duty of independence was motivated by fraudulent intent. But that is not what the complaints allege.

Accordingly, none of plaintiffs' allegations of improper appraisal methods raises a strong inference of Deloitte USA's knowledge of the Parmalat fraud.

b. Improper Auditing Practices

Plaintiffs next contend that culpable knowledge can be inferred from Deloitte USA's allegedly improper audits of Parmalat USA.

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[133] *See, e.g., In re Oxford Health Plans, Inc. Sec. Litig.*, 51 F. Supp. 2d 290, 294 (S.D.N.Y. 1999) ("generalized economic interests" such as "receipt of compensation and the maintenance of a profitable professional business relationship" does not give rise to strong inference of *scienter* (citing cases)); *accord Stone & Webster*, 414 F.3d at 215 ("[A]bsent truly extraordinary circumstances, an auditor's motivation to continue a profitable business relationship is not sufficient by itself to support a strong inference of scienter.").

Allegations that an auditor failed to follow GAAS or other auditing procedures do not alone support a claim of fraud.[134] "Only where such allegations are coupled with evidence of 'corresponding fraudulent intent,' might they be sufficient."[135] Accordingly, the issue is not whether plaintiffs have alleged GAAS violations, but whether they have alleged facts indicating that those violations were motivated by or indicative or products of fraudulent intent.

The complaints allege that Deloitte USA encountered obvious signs that something was amiss at Parmalat, but failed to investigate and blow the whistle. Plaintiffs therefore rely on a theory of recklessness to show fraudulent intent.[136] The Second Circuit defines reckless conduct as conduct that is "highly unreasonable" and represents "an extreme departure from the standards of ordinary care . . . to the extent that the danger was either known to the defendant or so obvious that the defendant must have been aware of it."[137] "[A]n egregious refusal to see the

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[134] *Novak*, 216 F.3d at 309 (citing *Stevelman v. Alias Research Inc.*, 174 F.3d 79, 84 (2d Cir. 1999); *Chill v. General Elec. Co.*, 101 F.3d 263, 270 (2d Gr. 1996).

[135] *Id.* (quoting *Chill*, 101 F.3d at 270).

[136] Rule 9(b) can be satisfied by allegations of "conscious recklessness – i.e., a state of mind approximating actual intent, and not merely a heightened form of negligence – or actual intent." *Id.* (quoting *Novak v. Kasaks*, 997 F. Supp. 425 (S.D.N.Y. 1998)) (quotations omitted).

[137] *Id.* (quoting *Rolf v. Blyth, Eastman Dillon & Co., Inc.*, 570 F.2d 38, 47 (2d Cir. 1978) (quoting *Sanders v. John Nuveen & Co.*, 554 F.2d 790, 793 (7th Cir. 1977) (ellipsis in original))).

obvious, or to investigate the doubtful, may in some cases give rise to an inference of . . . recklessness."[138]

(1) Reimbursement Credits

Plaintiffs argue that it should have been obvious to Deloitte USA that something improper was going on at Parmalat because it knew that Parmalat's reimbursement credits were bogus. They contend that Deloitte USA knew this because it conducted a successor audit of Parmalat USA in 1999 and discovered that Parmalat USA had not collected on any of the credits it had received from 1995 to 1998. This is unavailing.

The complaints do not allege why Parmalat's failure to pay past credits within a few years necessarily or probably should have indicated that it never would pay them. They do not allege, for example, that Parmalat had promised to the pay reimbursement credits within a certain time frame or that its consistent practice prior to 1995 had been to pay reimbursement credits more quickly. Accordingly, it cannot be said that Parmalat's failure to pay past reimbursement credits within a four-year span should have signaled to Deloitte USA that its credits were a sham altogether, let alone that Parmalat's insiders were engaged in a fraudulent scheme to loot the company.

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[138] *Id.* (quoting *Chill*, 101 F.3d at 269 (quoting *Goldman v. McMahan, Brafman, Morgan & Co.*, 706 F. Supp. 256, 259 (S.D.N.Y. 1989) (ellipsis in original))).

Plaintiffs contend also that Deloitte USA should have known something was amiss at Parmalat when Deloitte Italy and Parmalat refused to provide it with "confirmation . . . of the calculations and nature . . . [and] accounting treatment" of the reimbursement credits.[139] If Parmalat and Deloitte Italy were evasive in providing information material to Parmalat USA's audit and Deloitte USA failed to follow up, this perhaps would go some way towards raising an inference of recklessness.[140] But plaintiffs' allegations nevertheless are insufficient.

The complaints do not explain what it means to receive "confirmation" of the "calculations and nature" of reimbursement credits, or what a response to a request for such "confirmation" would look like. The most reasonable interpretation the Court can supply, bearing in mind that it must construe the pleadings in the light most favorable to plaintiffs, is that Deloitte USA sought confirmation that Parmalat USA had booked the proper amount of credits and that it had accounted for them properly by booking them as reimbursement of expenses as opposed to a capital contribution from Parmalat. Plaintiffs do not explain, however, how Deloitte Italy's or Parmalat's failure to answer these questions would have indicated to

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[139] *Pappas* SAC ¶ 93.

[140] *See, e.g., SEC. v. McNulty*, 137 F.3d 732, 741 (2d Cir. 1998) (pleadings sufficient where defendant allegedly included false statements in SEC filings despite "the obviously evasive and suspicious statements made to him" by the corporate officials upon whom he was relying for this information and despite outside counsel's recommendation that these statements not be included).

Deloitte USA that Parmalat never would pay the reimbursement credits or that Parmalat's insiders were committing fraud.

Plaintiffs do not allege that Parmalat or Deloitte Italy failed to confirm that Parmalat would pay the credits or that it had the financial means to do so. Had Parmalat or Deloitte Italy been evasive in answering *these* questions, perhaps this would have made the fact that Parmalat was concealing financial difficulties sufficiently obvious to Deloitte USA to support an inference of conscious recklessness. But that is not what plaintiffs allege.

The allegations imply that Deloitte USA acted improperly in failing to ask these questions. This, however, amounts at best to a claim that Deloitte USA violated auditing standards or that it was negligent, perhaps even grossly so. But it does not raise the inference that Deloitte USA recklessly disregarded a substantial possibility that Parmalat was being looted.[141]

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[141] *Cf. Ziemba v. Cascade Int'l, Inc.*, 256 F.3d 1194, 1210-11 (11th Cir. 2001) (failure of subsidiary's auditor to investigate warning signs that parent might not be able to give subsidiary the capital infusion it needed to survive and therefore to issue going concern qualifications raised inference of gross negligence but not fraud).

Plaintiffs contend also that Zucchinali of Deloitte Italy told Pickette of Deloitte USA in a January 18, 2000 email that the reimbursement credits were part of a program referred to as "loss absorptions," meaning they were "contributions – income for the receiving company – from other Parmalat companies to cover losses." *Pappas* SAC ¶ 97. While use of the phrases "loss absorption" and "to cover losses" perhaps was suspicious, Zucchinali's email reasonably can be read as an innocent

(2) Going Concern Qualifications

The allegations regarding going concern qualifications fail to raise an inference of culpable knowledge as well.

Plaintiffs allege that, in connection with Parmalat USA's audit for the years 1999 to 2001, Deloitte USA improperly relied on management representations instead of "actual audit evidence" that Parmalat intended to provide continuing financial support to the Companies. But GAAS, AU Section 333.02, provides that "representations from management are part of the evidential matter the independent auditor" must obtain.[142] Moreover, AU Section 333.11 provides that

> "if the independent auditor performs an audit of the financial statements of a subsidiary but does not audit those of the parent company, he or she may want to obtain representations from management of the parent company concerning

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explanation that the reimbursement credits were promises to pay Parmalat subsidiaries for losses sustained or expenses borne on behalf of the parent company. The fact that Pickette received the January 18 email therefore does not raise a strong inference that Deloitte USA knew the reimbursement credits were part of a fraudulent scheme.

[142] American Institute of Certified Public Accountants, Codification of Statements on Accounting Standards, AU § 333.02 [hereinafter, "AICPA"]. *See Pappas* SAC ¶ 75 (equating AICPA with GAAS).

Plaintiffs relied on this document in making their allegations. *See, e.g., id.* ¶¶ 75, 89-91. The Court therefore may consider it on these motions. *E.g., Chambers,* 282 F.3d at 152-53.

> matters that may affect the subsidiary, such as related-party transactions *or the parent company's intention to provide continuing financial support to the subsidiary.*"[143]

Plaintiffs claim that this does not get Deloitte USA off the hook because AU Section 333.02 permits an auditor to use management representations as a supplement to other audit evidence, not as "a substitute for the application of those auditing procedures necessary to afford a reasonable basis for an opinion regarding the financial statements under audit."[144] Plaintiffs fail to allege, however, what else beside management representations would qualify as "actual audit evidence" of Parmalat's future intent to continue supporting the Companies and therefore why management representations alone were insufficient. In any event, even if there were some other audit evidence that Deloitte USA failed to obtain, plaintiffs' allegations would amount only to a claim that Deloitte USA violated GAAS, which is not enough to raise an inference of culpable knowledge.[145]

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[143] AICPA AU § 333.11 (emphasis added).

[144] *Id.* AU § 333.02.

[145] Plaintiffs point also to AU Section 333.14, which provides that "[i]f the auditor is precluded from performing procedures he or she considers necessary in the circumstances with respect to a matter that is material to the financial statements, even though management has given representations concerning the matter, there is a limitation on the scope of the audit, and the auditor should qualify his or her opinion or disclaim an opinion." *Id.* AU § 333.14. But plaintiffs do not allege that Deloitte USA was precluded from performing auditing procedures in connection with its audits for the years 1999 to 2001. Plaintiffs perhaps allege that

The only allegations that bring plaintiffs close to raising a sufficient inference of recklessness are the claims that Bigogno of Deloitte Italy refused to honor Potts' request for audit evidence in connection with Parmalat USA's 2002 audit. As noted, allegations that Deloitte Italy or Parmalat refused to provide necessary audit information to Deloitte USA may be sufficient to satisfy Rule 9(b). The Court need not decide the issue, however. Even assuming that the Bigogno-Potts exchange is sufficient to raise a strong inference of Deloitte USA's culpable knowledge, this would not help plaintiffs on the proximate cause issue.

The Bigogno-Potts exchange allegedly occurred on May 8, 2003. This, however, was after Deloitte USA's audits of Parmalat USA for the years 1999 to 2001 and its April 30, 2003 appraisal of Farmland's assets. The only alleged conduct of Deloitte USA that occurred after May 8, 2003, was its 2002 audit of Parmalat USA. But plaintiffs do not allege that GECC or any other party relied on audited financial statements for 2002 in deciding whether the sale-leaseback transaction should go forward. They allege only that GECC required Parmalat USA's audited financial statements for the years 2000 and 2001, and that it received *unaudited* financial statements for 2002. Accordingly, it cannot be said that the Bigogno-Potts exchange made it reasonably foreseeable that Deloitte USA's actions, at the time they were taken, would lead

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Deloitte USA was precluded from performing auditing procedures in connection with its 2002 audit because of Bigogno's refusal to provide audit evidence to Potts. This allegation is addressed in the text.

to the looting of the proceeds of the sale-leaseback transaction.

(3) Overstatement of Goodwill

Finally, allegations that Deloitte USA failed to reveal that Parmalat USA's goodwill was overstated in financial statements fail to raise a strong inference of fraudulent intent.

According to plaintiffs, Parmalat USA reported that its goodwill was approximately $202 million at the end of fiscal year 2000 and $198 million at the end of fiscal year 2001. This constituted approximately half of Parmalat USA's total reported assets in those years. Plaintiffs do not explain, however, what is improper or misleading about these values. They simply claim that "the results of the underlying operations of Parmalat-USA and its subsidiaries did not justify" the reported values. In addition, they allege that even though Parmalat USA reduced the company's reported goodwill by $26.5 million in 2002, "this write-down was not sufficient."[146] Allegations that reported goodwill values were "unjustified" or that a reduction in values was "insufficient" are conclusions. They are not facts constituting strong circumstantial evidence of conscious misbehavior or recklessness.

Plaintiffs contend also that "Deloitte recklessly did not require that [the 2002 write-down of goodwill] flow through to the consolidated financial statements of

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[146] *Pappas* SAC ¶¶ 130-131.

Parmalat-SpA."[147] The vague reference to "Deloitte" fails to indicate that Deloitte USA, which audited only Parmalat USA and apparently had no direct connection to Parmalat, was responsible for ensuring that information "flow through" to Parmalat's financial statements. Indeed, plaintiffs state elsewhere in the pleadings that this was the responsibility of Deloitte Italy.[148] The allegation therefore fails to raise a strong inference of Deloitte USA's fraudulent intent.

2. Imputed Knowledge

The fact that plaintiffs have failed to allege conduct by Deloitte USA itself that would give rise to an inference of culpable knowledge is not the end of the story. The complaints allege that Deloitte Italy was involved intimately in the Parmalat fraud and that its knowledge of wrongdoing, if any, should be imputed to Deloitte USA.

a. Agency

Plaintiffs' first theory is that Deloitte Italy was DTT's agent, and that DTT in turn was Deloitte USA's agent.[149] As will become clear, however, even assuming

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[147] *Id.* ¶ 131.

[148] *Id.* ¶ 191.

[149] It is possible to interpret the complaints as alleging an alter ego theory, despite their express references to agency law. The difference is immaterial, however. At least one court has held that the test for determining the existence of an agency relationship is the same as the test for determining whether two related corporations, such as a parent and a subsidiary, are *alter egos*. *See*

plaintiffs adequately have alleged Deloitte Italy's knowledge of the Parmalat fraud and its agency relationship with DTT, they have not alleged adequately that DTT was Deloitte USA's agent.

As the Court previously has explained,

> "An agency relationship exists under New York law when there is agreement between the principal and the agent that the agent will act for the principal and the principal retains a degree of control over the agent. The element of control often is deemed the essential characteristic of the principal-agent relationship. To bind a principal, an agent must have authority, whether apparent, actual or implied. Actual authority arises from a principal's direct manifestations to the agent. It may be express or implied, but in either case it exists only where the agent may reasonably infer from the words or conduct of the principal that the principal has consented to the agent's performance of a particular act.[150]

Kashfi v. Phibro-Salomon, Inc., 628 F. Supp. 727, 735 (S.D.N.Y. 1986) (citing *Fidenas A.G. v. Honeywell, Inc.*, 501 F. Supp. 1029, 1037 (S.D.N.Y. 1980)). *But see Royal Indus. Ltd. v. Kraft Foods, Inc.*, 926 F. Supp. 407, 413 (S.D.N.Y. 1996) ("If . . . an agency arrangement is alleged, then the plaintiff should not have to also allege domination and intent to defraud for the claim to survive."). In any event, both tests requiring a showing of control, *Parmalat*, 375 F. Supp. 2d at 290-292, which plaintiffs have failed adequately to allege.

[150] *Parmalat*, 375 F. Supp. 2d at 290 (citing authority) (citations and quotations omitted).

(1) Common Officers and Directors

Plaintiffs' allege first that eleven of twenty-six members of DTT's board of directors were partners of Deloitte USA, and that DTT and Deloitte USA shared a chief executive officer and a chief financial officer.[151] But the fact that two corporations share officers and directors does not establish by itself that one corporation is the agent of the other. It is a "well established principle [of corporate law] that directors and officers holding positions with a parent and its subsidiary can and do 'change hats' to represent the two corporations separately, despite their common ownership."[152] "[C]ourts generally presume 'that the directors are wearing their 'subsidiary hats' and not their 'parent hats' when acting for the subsidiary.[153] Plaintiffs offer no allegations to overcome this presumption.[154]

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[151] *Pappas* SAC ¶ 273.

[152] *United States v. Bestfoods*, 524 U.S. 51, 69-70 (1998) (quoting *Lusk v. Foxmeyer Health Corp.*, 129 F.3d 773, 779 (5th Cir. 1997) (alteration in original); citing *Fisser v. Int'l Bank*, 282 F.2d 231, 238 (2d Cir. 1960)).

[153] *Id.* (quoting P. BLUMBERG, LAW OF CORPORATE GROUPS: PROCEDURAL PROBLEMS IN THE LAW OF PARENT AND SUBSIDIARY CORPORATIONS § 1.02.1, p. 12 (1983); citing *United States v. Jon-T Chemicals, Inc.*, 768 F.2d 686, 691 (5th Cir. 1985), *cert. denied*, 475 U.S. 1014 (1986)).

[154] *See id.* (fact that parent and subsidiary shared officers and directors not enough to hold parent vicariously liable under Comprehensive Environmental Response, Compensation and Liability Act).

Moreover, the overlap of DTT's management with that of Deloitte USA is equally consistent with the inference that DTT controlled Deloitte USA as it is with the inference that Deloitte USA controlled DTT. Indeed, plaintiffs allege that "DTT exercised authority and control over the various Deloitte member firms engaged in Parmalat audits."[155] Deloitte USA cannot be said to have controlled DTT if, as is alleged, DTT was in control of Deloitte USA.[156]

(2) Deloitte USA's Financial Support of other Deloitte Entities

Plaintiffs next allege that Deloitte USA paid the salaries and benefits of ten to forty percent of DTT's employees, "financially subsidized Deloitte's global integration process for the less profitable member firms such as [Deloitte Italy]," and provided funding to pay for claims brought against Deloitte member firms when their liability insurance did not provide complete coverage.[157]

The fact that one corporation finances some of the operations of another does not necessarily establish an agency relationship. The provision of financing does not in every circumstance establish the ability to control the way the beneficiary corporation performs its work. And where it does – perhaps because the

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[155] *Pappas* SAC ¶ 266; *see also id.* ¶¶ 254-271 (alleging DTT's control over Deloitte firms).

[156] *In re Parmalat Sec. Litig*, 377 F. Supp. 2d 390, 406 (S.D.N.Y. 2005).

[157] *Pappas* SAC ¶¶ 273-275.

financing corporation can threaten to cut off future support – it does not necessarily entail the beneficiary's power to act on the financing corporation's behalf.[158] The allegations regarding Deloitte USA's role in the Deloitte organization suggest at most that Deloitte USA was a particularly profitable Deloitte member firm and that DTT – the umbrella entity allegedly capable of controlling the Deloitte member firms – therefore used the proceeds from Deloitte USA's operations to fund the operations of itself and certain other member firms. The allegations by themselves do not support the inference that Deloitte USA controlled the manner of DTT's performance, or that DTT acted on its behalf.

(3) Dispute Between Deloitte USA and Deloitte Italy

Finally, plaintiffs allege that when Mamoli of Deloitte Italy objected to the idea of Deloitte USA appraising Farmland's assets while simultaneously serving as Parmalat USA's auditor, Deloitte USA "secure[d] the intervention of DTT's Horstmann to "persuade" Mamoli to withdraw his objection.[159] According to plaintiffs, this demonstrates that Deloitte USA controlled DTT.[160]

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[158] *See Itel Containers Int'l Corp. v. Atlanttrafik Exp. Serv. Ltd.*, 909 F.2d 698, 702-03 (2d Cir. 1990) (no agency relationship established where one company provided financing to another, but beneficiary "was meant to, and did, operate independently").

[159] *Pappas* SAC ¶ 228-231.

[160] *Id.* ¶ 276.

This is unavailing. Alleging that a company requested a representative of its parent organization to resolve its business dispute with a sister company is far from alleging that it controlled the parent organization. Plaintiffs do not allege, for example, that anyone at Deloitte USA ordered – or had the authority to order – Horstmann to intervene, let alone to resolve the dispute the way he did. Rather, they allege that it was Horstmann's job to resolve disputes between Deloitte member firms and that even though it was Deloitte USA that requested his help, Horstmann was acting on behalf of DTT when he intervened. Accordingly, apart from the conclusory and therefore insufficient allegation that Deloitte USA was "dominant over DTT," and "impose[d] its will" on Deloitte Italy,[161] plaintiffs do not allege anything about DTT's involvement in the dispute that would support the conclusion that Deloitte USA controlled DTT.

b. Joint Venture

Plaintiffs' second theory of imputed knowledge is that all of the Deloitte entities were engaged in a joint venture. Knowledge of a joint adventurer is imputed to its co-adventurers.[162]

> "A joint venture is a special combination of two or more persons where in some specific venture a profit is jointly sought. The indicia of the existence of a joint venture are: (i) acts

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[161] *Id.*

[162] *See Mattis v. Bankers Trust Co.*, 717 F.2d 683, 689 n.9 (2d Ch. 1983) (citing cases).

manifesting the intent of the parties to be associated as joint venturers; (ii) mutual contribution to the joint undertaking through a combination of property, financial resources, effort, skill or knowledge; (iii) a measure of joint proprietorship and control over the enterprise; and (iv) a provision for the sharing of profits and losses. The ultimate inquiry is whether the parties have so joined their property, interests, skills and risks that for the purpose of the particular adventure their respective contributions have become as one and the commingled property and interests of the parties have thereby been made subject to each of the associates on the trust and inducement that each would act for their joint benefit."[163]

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[163] *Decker, Decker & Assocs., Inc. v. Ass'n of Nat'l Advertisers, Inc.*, No. 108398/06, 2007 WL 1053881, *5 (N.Y. Sup. Ct. N.Y. Co. 2007) (citing authority) (citations and quotations omitted).

Plaintiffs argue that New Jersey law differs from New York law in that it does not require a showing of intent to establish the existence of a joint venture. This is incorrect. *See, e.g., Ginsberg v. Bistricer*, No. C-113-98 2007 WL 987169, * 11 (N.J. Super. App. Div. Apr. 4, 2007) ("In determining whether a joint venture was formed, the court's primary consideration is the intention of the parties."); *Sullivan v. Jefferson, Jefferson & Vaida*, 167 N.J. Super. 282, 290, 400 A.2d 836, 840 (N.J.Super. App. Div. 1979) ("[T]he basic criterion of a joint venture . . . [is] the voluntary agreement of the parties to form a relationship with the intent to create a joint venture."). In any event, as will become clear, plaintiffs have failed to allege the joint control element of a joint venture. The intent of the Deloitte entities therefore is beside the point.

Plaintiffs' theory essentially is that the Deloitte member firms were joint adventurers in auditing Parmalat's financial statements, as each provided auditing services under the Deloitte aegis to different Parmalat entities according to the same auditing standards and shared in the profits and fees generated by the Parmalat account.[164] The Court previously rejected just such a theory, holding that "allegations that several firms worked on specific Parmalat-related assets together and that they all followed the same auditing standards" did not give rise to an inference that the firms had mutual control over each other and the purported enterprise.[165] In other words, it failed to indicate that each firm's individual work on a particular Parmalat project had "become as one" with the work of its sister firms.

Plaintiffs attempt to distinguish this case by arguing that the alleged joint venture here was not the *auditing* of Parmalat, but the *certification* of its financial statements.[166] They claim that each member firm had the ability to withhold certification of a Parmalat subsidiary's financial statements, and therefore the *de facto* power to ensure that Parmalat's consolidated financial statements did not receive certification or an unqualified opinion.

This is unavailing. One of the essential features of a joint venture is an agreement among the parties to

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[164] *See Pappas* SAC ¶¶ 284-303.

[165] *Parmalat*, 421 F. Supp. 2d at 717-18 (applying Illinois law and quoting *Parmalat*, 377 F. Supp. 2d 390, 407).

[166] *See* Pappas SAC ¶ 280.

share profits and losses from the undertaking. The Deloitte firms, however, presumably did not earn profits or suffer losses in connection with their certification of Parmalat's financial statements, but in connection with their provision of auditing services to various Parmalat entities. That is, they presumably received payment regardless of whether they issued certifications or qualified their audit reports. Plaintiffs allege no facts to rebut this presumption.[167] Hence, it cannot be said that the Deloitte entities engaged in a joint venture, the sole object of which was to ensure that Parmalat's consolidated financial statements were certified.

Plaintiffs claim also that there was joint control in this case because each member firm "had the power to, and did, control the nature, amount, and flow of information to other. Deloitte member firms regarding the Parmalat entity, subsidiary, or affiliate under audit."[168] But this cuts the other way. It suggests that the firms did *not* have control over one another's work, but instead acted as individual entities working on discrete projects. If there were a free flow of information and each firm had unfettered access to information concerning a sister firm's project, then perhaps one could infer that the work of all the Deloitte firms had "become as one." The complaints, however, allege the opposite.

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[167] *See id.* 288 (alleging that Deloitte firms shared in the "profits and losses in their overall *audits*" (emphasis added)).

[168] *Id.* ¶ 300.

In the last analysis, the Court is not persuaded that plaintiffs have alleged that DTT was Deloitte USA's agent, or that the Deloitte member firms were engaged in a joint venture. Any knowledge Deloitte Italy and DTT might have had of the Parmalat fraud therefore cannot be imputed to Deloitte USA.[169]

As plaintiffs have failed adequately to allege Deloitte USA's knowledge that Parmalat's insiders were committing fraud, they have failed to allege that it was reasonably foreseeable to Deloitte USA that its conduct eventually would result in the looting of Farmland's assets. Contrary to plaintiffs' assertions, this case is indistinguishable from *Bloor*. Plaintiffs allege at most that Deloitte USA caused the sale-leaseback transaction to occur. But they do not allege adequately that Deloitte USA proximately caused the proceeds of that transaction to be looted. Accordingly, plaintiffs have failed to plead proximate cause for purposes of their claims against Deloitte USA.

Conclusion

The motions of Deloitte USA, DTT, Deloitte Italy, GTI, GT USA, the Bank of America Defendants, the Credit Suisse Defendants, and BNL to dismiss the

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[169] As noted, plaintiffs' allegations arguably are more consistent with the conclusion that Deloitte USA was DTT's agent, rather than *vice versa*. This does not help plaintiffs, however, "as an agent generally is not liable for the acts of co-agents." *In re Parmalat Sec. Litig.*, 421 F. Supp. 2d 703, 707 (S.D.N.Y. 2006).

second amended complaints of Smith[170] and Pappas[171] are granted in their entirety. The motion of Banca Intesa to dismiss Smith's second amended complaint[172] is granted in its entirety as well.

SO ORDERED.

Dated: August 8, 2007

/s/
Lewis A. Kaplan
United States District Judge

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[170] 04 MD 1653 docket items 703, 686, 689, 696, 695, 702, 713, 693; 06 Civ. 0383 docket items 185, 168, 171, 176, 175, 182, 195, 174.

[171] 04 MD 1653 docket items 721, 1276, 722, 734, 733, 743, 727, 738; 06Civ. 3109 docket items 9, 10, 13, 27, 25, 39, 20, 32.

[172] 04 MD 1653 docket item 709; 06 Civ. 0383 docket item 189.

APPENDIX F

UNITED STATES CODE
TITLE 15. COMMERCE AND TRADE
CHAPTER 2B. SECURITIES EXCHANGES

15 U.S.C. § 78u-4. Private securities litigation

* * *

(b) Requirements for securities fraud actions.

(1) Misleading statements and omissions. In any private action arising under this title in which the plaintiff alleges that the defendant--

(A) made an untrue statement of a material fact; or

(B) omitted to state a material fact necessary in order to make the statements made, in the light of the circumstances in which they were made, not misleading;

the complaint shall specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which that belief is formed.

(2) Required state of mind. In any private action arising under this title in which the plaintiff may recover money damages only on proof that the defendant acted with a particular state of mind, the complaint shall, with respect to each act or omission

alleged to violate this title, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind.

(3) Motion to dismiss; stay of discovery.

(A) Dismissal for failure to meet pleading requirements. In any private action arising under this title, the court shall, on the motion of any defendant, dismiss the complaint if the requirements of paragraphs (1) and (2) are not met.

(B) Stay of discovery. In any private action arising under this title, all discovery and other proceedings shall be stayed during the pendency of any motion to dismiss, unless the court finds upon the motion of any party that particularized discovery is necessary to preserve evidence or to prevent undue prejudice to that party.

(C) Preservation of evidence.

(i) In general. During the pendency of any stay of discovery pursuant to this paragraph, unless otherwise ordered by the court, any party to the action with actual notice of the allegations contained in the complaint shall treat all documents, data compilations (including electronically recorded or stored data), and tangible objects that are in the custody or control of such person and that are relevant to the allegations, as if they were the subject of a continuing request for production of documents from an opposing party under the Federal Rules of Civil Procedure.

(ii) Sanction for willful violation. A party aggrieved by the willful failure of an opposing party to comply with clause (i) may apply to the court for an order awarding appropriate sanctions.

(D) Circumvention of stay of discovery. Upon a proper showing, a court may stay discovery proceedings in any private action in a State court, as

necessary in aid of its jurisdiction, or to protect or effectuate its judgments, in an action subject to a stay of discovery pursuant to this paragraph.

(4) Loss causation. In any private action arising under this title, the plaintiff shall have the burden of proving that the act or omission of the defendant alleged to violate this title caused the loss for which the plaintiff seeks to recover damages.

* * *